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ILLINOIS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

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LETTERS TO THE EDITOR

Sirs:

The experience of our firm with punched tape accounting may be interesting in the light of the article on the same subject by Ralph Bearden in the Spring 1961 issue of *The Illinois CPA*.

The principal observation I would make is that I don't think it cost me any more over all for punched tape but yet no less than manual handling. It may be that further use of the system would have proved it to be less costly. We do know that it did not serve to eliminate any payroll in our office. One client didn't like the tab form for statement purposes; it had to be typed. We felt obliged to prepare complete income statements before putting the data on tape in order to eliminate errors. We were doing the work both manually and by machine. Pre-coding of transactions also takes time.

An objection to punched tape lies in the fact that a firm is inclined to think in terms of getting more work for the machine in order to keep it busy. The class of work needed is not of a professional nature suitable to the ability of the practitioner unless he is solely a tax practitioner interested in every kind of a tax problem. Even then he will obtain some not too desirable work. Too much writeup work tends to make assistants unhappy, in thinking that they are not working up to their ability and therefore their pay check is smaller and the future is not so promising.

A further objection lies in the mental confusion which exists when more than one method of accounting is used by the same man and the need for the training of new men to punched tape accounting. Every accountant has been trained in and is familiar with the standard double entry ledger, manually kept. Most of our clients use this latter method.

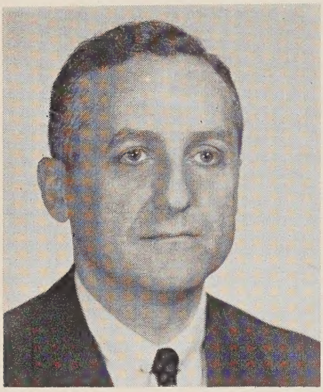
In the above discussion I am thinking only of clients who have no bookkeeper and no one available who can be trained to do book work. For larger clients it is possible that direct use of paper tape and processing centers may be advantageous cost-wise.

We have frequently felt that the use of tab never costs less but it does produce more paper and records, faster. It is also thought that the best use of tab is where more than one run or classification is needed from the same punched cards, such as sales by states, by salesmen, by products, etc. Such a run, however, is not needed by very small firms. Payroll is also adaptable to tab, because a run must be made for total payroll, total withholding tax, total FICA and total other deductions, and a run must also be made to allocate these amounts and collect them by employee. Here again the employer of less than ten may have small use for tab.

We strongly question the materiality of the time and money saving, if any, by practitioners in using paper tape.

Yours truly,
THEODORE N. PERRY, CPA
Chicago, Illinois

HARRY I. GROSSMAN



At the Spring Awards Dinner held last March 28 in The Conrad Hilton Hotel, Vice President Joseph F. Sullivan was just completing a warm, friendly and interested presentation of the Society's medals to the candidates achieving the highest grades in the November 1960 CPA examination. Joe had already awarded the silver medal. He was in the act of passing the gold medal to the first place winner when he suffered a fatal heart attack and collapsed in view of the horror stricken audience which but a split moment before was completely absorbed in his story of the winners' careers and what served to bring them to the forefront that night.

The grief which seized those of us who knew Joe well was a measure of the man. The memory of that night will not fade easily.

If it can be of consolation to any of us that Joe passed away while in the very act of serving those interests which were close to his heart, we have such consolation. A member of the Society since 1938, Joe contributed much to the growth and stature of the organization as well as to the profession itself. He served on many committees as chairman and as member and contributed significantly to the highly important work of the special survey committee which was in existence from 1954 through 1957. He was also most active in the work of the AICPA.

President's MESSAGE

Joe's counsel, support and understanding were a bulwark and a great comfort to me during my administration. He never spared himself when asked to lend a hand. He had a genius for making me feel that I was conferring a favor upon him whenever I asked him for help. Joe's professional stature, high as it was, never obscured the warm human being that he was. Those who were privileged to know him well reacted to him in affection. I am sure this must have been one of the great compensations in Joe's life.

Himself an Illinois Society medal winner, Joe had a keen interest in the encouragement of young people starting out on a public accounting career and in the recognition of scholastic attainments. Shortly before the last Awards Dinner, Joe remarked to one of his partners that in his opinion not enough time was customarily devoted to the actual awards ceremony. He was anxious, as was typical of him, to give ample due to the achievement of the beginner. He prepared his Awards speech carefully and took time out of his busy day to meet with the winners personally in order that he have a direct and firsthand knowledge of his subject matter. He was anxious to convey, and by his actions could hardly fail to convey, to the medal winners that he and the Society were interested in them as individuals.

We in the Illinois Society are thankful to have had the productivity, loyalty and devotion of Joe Sullivan in our ranks for something over two decades. His loss in the prime of his life is that much heavier to bear. Those of us whom Joe left behind have an obligation to carry on for him and the other giants of our Society's history who helped put us where we are today. I echo the sentiments of one of our past presidents who was shocked to learn of the tragedy on the morning after the Awards Dinner. He slowly shook his head and simply said, "Joe was not expendable."

Our deepest sympathy goes to the family of Joseph F. Sullivan and to his partners. We share in their great loss.

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A Thorough Grasp of the Mission and Method of Accounting Will Disclose Its Underlying Logic

Mission and Method

By A. C. Littleton

It may seem a mere truism to say accounting is a technology whose service is focused upon aiding men to understand a business enterprise and its management. The thought is more than trite truism, more than definition, assumption or postulate. It reaches deeply into an area of broad objectives. As an objective, the idea is supported by man's natural urge to know, to benefit from experience, to extend his understanding.

Accounting has been functioning in aid of this need for at least five centuries. Over a few recent generations it has developed greatly increased capacity for effectively serving this need. And the limit has not yet been reached. But now a question arises: How, and how fast, shall growth continue?

If a broad objective is needed as a springboard, the one mentioned above would seem appropriate. Research could then be directed toward sub-objectives suitably supporting the primary reason that accounting exists. For relevant sub-objectives direct the course that accounting sub-actions take.

In spite of some opinion to the contrary, there is good reason for believing that little is basically at fault with accounting ways and means. Real issues are more likely to be found in the area of ideology, particularly that associated with objectives and sub-objectives. The mechanics of modern accounting action can adjust to whatever ideology shall be found most rationally in tune with a graduation of rational objectives.

Needed: A Philosophy of Mission

Accounting ideas and concepts have not yet been organized into an integrated body of doctrine capable of matching the purposeful integration of the actions which make accounting a technology. Herein lies the present challenge. Accountants have a deep understanding of their technology; and they have a clear sense of mission. But a recognizable philosophy of the mission of that technology seems lacking. Sooner or later a clear analysis of the mission of accounting should be joined with a philosophy of method.

A philosophy of mission and of method need not and should not, be philosophical in origin or form. It might very appropriately consist of an integrated body of doctrine designed to show why accounting service is needed and, in detail, why and wherein accounting has capacity to render its kind of service, that is, the service of making enterprise experience so knowable that understanding may grow out of that knowledge, and

rational action out of that understanding.

Before accounting doctrine can be organized into an integrated whole, many separate ideas, concepts, objectives must be found, stated, justified and assembled. It may prove a useful approach to this kind of basic research to look beneath a variety of accounting objectives related to helping men to understand a business enterprise. If we can know why men have wished to understand, it may become clear that accounting has had a long career of serving a deep-lying human need.

Mankind has been endowed with intellect beyond all other creatures. This quality includes two significant and interrelated features:

—An urge to understand

—A capacity to benefit from experience

Understanding can be a goal; experience can be a means of approaching that goal. It is part of man's nature to have capacity to understand, capacity to know in order to understand, capacity to examine experience in order to know, capacity to take present action based on experience and aimed toward an expected future.

It must have been an urge to understand their business enterprise that motivated the early innovators of accounting. The data organized by those techniques still derive out of and speak of enterprise experience. Only decisions of enterprise management created—and still create—the exchange-priced transactions which in turn provided quantitative data regarding prior experience, an element indispensable to an understanding of the present.

Intergration of Real and Nominal Accounts

Perhaps the most significant innovation made long ago was the integration of real and nominal accounts. It is this integration which gives accounting the capacity to use exchange-priced dollars to picture prior experience, and thus to help men convert experience into understanding, and to use understanding in aid of rational next decision-actions. The mission of accounting still rests upon such objectives as these. Disintegration of the tight integration between real and nominal accounts would be fatal to that mission. Contrived and artificial integration, even though trial balance totals were still equal, would seriously impair the analytical message carried by financial statements.

An important limitation in accounting appears in the fact that account figures do not act automatically to generate understanding. Digits, even organized digits, are silent and inanimate. They function only as users, possessed of an urge to understand and a capacity to benefit from experience, undertake to extract meaning from account figures – meaning, let it be noted, relevant to the users' own problems and purposes.

It is important in basic research to visualize men working with accounting method to guide raw data toward intelligible communication; to visualize other men studying communicated account data. The image of accounting should be readily recognized as that of a technology mediating between enterprise experience and men having problems of decision-actions before them.

Such an image would make it clear

that full communication of meaning will be affected, not only by technical methodology, but by the capacity both groups of men shall have for understanding the objectives, needs, limitations of each other.

Human factors are inseparable from accounting. Changes in method can dilute the communication unless the user's understanding has been suitably upgraded earlier. Changes, therefore, should be evolutionary only; they should be well thought through, not only justifiable but justified within the user's knowledge and understanding.

The underlying sense of the well known phrase "generally accepted" is that understanding and justification give strength to an idea. Accounting progress over several generations and increased user understanding have moved forward together. It would seem that explanation of ideas and justification of limitations—in a word, accounting theory—are likely to become more effective instruments toward acceptance and use of technical advances than legislative fiat or any type of unsupported preferences.

To one who understands accounting only superficially, its method may seem far more flexible to individual wish than is the case. This fact might very well cue an effort on the part of accountants to help more people to understand the limits within which accounting must function; the limits and the reasons for the limits, beyond which accounting should not be set into a uniform pattern; the limits beyond which accounting, working as it must with enterprise actual experience, cannot vary its data according to the winds of economic change.

Mission Rests on Service Provided

A philosophy of accounting mission would best be centered on certain concepts of needed services—services which could mediate in the markets the actions of enterprise management and the needs men have to know the factual results of those actions. Specifically, these needs are to understand enterprise status as of definite dates and to appraise enterprise management accomplishments.

The concepts of accounting services would be those of a technology dedicated to dependably and systematically organizing decision-derived data toward intelligible communications; that of a technology which did not purport to be infallible, all inclusive, or strive to provide the sole answer to men's need to understand and to take action out of that understanding.

A philosophy of accounting method should derive basically from concepts involved in the accounting mission. For this, an integrated body of doctrine should include the reasons why accounting has within its method the capacity to serve men's various needs to understand a business enterprise. It is not enough to describe procedure; an act of doing should be illuminated by the knowledge of how that act was able to contribute to specific objectives, and through them, to other more distant objectives. There are illuminating ideas beneath every type of accounting action.

Method Relates Means to Ends

Method does not exist for its own sake. Method is made up of complex

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means related to definite ends. Method provides a suitable means only to the extent that the means can satisfactorily serve that end. An examination into the philosophy of method should therefore undertake to tie a wide variety of accounting actions into concepts lying within the philosophy of accounting mission. Each type of action, to justify its existence (that is, acceptance and use) should contribute in recognizable ways and degrees to the fulfillment of the accounting mission.

Accounting actions are many and varied and interrelated. Their known interrelations and customary sequences may have tended to obscure the way each could play a part in fulfilling the overall mission of this technology.

For these reasons it would seem appropriate that basic research should look beneath simple types of accounting action for clues to their reason for being. No doubt aspects of the mission of accounting would be found reflected, in some degree, within each type of action. Each justifiable type of action should be able to survive the test of serving the objectives of accounting better than another conceivable alternative. From an ensuing study of persuasiveness among alternatives, there should emerge reasons explaining why existing actions have capacity to contribute to a successful mission — that of making a business enterprise and its management understandable to interested parties.

Example: Spacial Arrangement of Data

Consider a few simple illustrative examples. A part of the theory of accounting method calls for the use of spacial arrangement of data to point up significant relationships within an enterprise. Reading meaning out of spacial arrangements requires knowledge of the ways that meaning can be expressed in this way.

This aspect of analytical data organization appeared quite early in the form of two summary accounts in the ledger: balance account; profit and loss account. When, in later years, summaries of account data were separated from the ledger, they were copies both as to facts and form of these two bi-lateral accounts.

By processing account data in two opposite columns, informative contrasts were made (1) of the means available in the enterprise (assets) and the sources of those means (equities); (2) the means converted into efforts to please customers (expense) contrasted with the accomplished success of those efforts (revenue). Moreover, by processing account data into two integrated report-statements, an informative contrast was created of enterprise capital (the tree) and enterprise income (the fruit). Neither report alone could be as informative as the two contrasted and integrated.

Modern financial statements skillfully expand the use of spacial arrangement to direct reader attention to relationships. The user, however, must know how relationships reveal meaning; if he does not, the presentation is merely quantitative and confusing.

This accounting development reveals rather than makes relationships. Before data appear in accounts, relationships exist among the transactions. Relation among accounts follows a matter of course. Enterprise capital is at work in transactions not in the accounts; management use of

capital produces results whether accounts are kept or not. The contribution made by accounts is that of converting into intelligible computations and communications this inherent integration of capital in action and the income produced by that action. Since financial statements integrate capital and income, they reflect and report on the interrelations among the judgments, decisions and actions management.

More Research Needed

A brief excursion is insufficient to penetrate into many reasons why accounting method is capable of carrying forward the accounting mission. Much more exploring is needed. Search beneath method to uncover ideas, concepts, objectives, and achievements would seem to be, for accounting, basic research. It would lead to inquiry into the relation between accounting philosophy of mission and its philosophy of method.

In the long run, basic research should be rewarding. As its results become widely known, accounting and accounting reports would become more understandable to more people. Basic research would demonstrate that accounting is more logical than it is traditional. A logical framework is less subject to easy change than a purely customary framework.

It would be a contribution if objectives were made clear and if the existence of inherent limitations to accounting actions were forcefully presented. Reader understanding of the limits affecting accounting would make financial statements more understandable to all concerned.

Research might well implement the thought that professional auditing, in effect, uses a special investigating methodology for examining into the extent to which the philosophy of accounting mission and the philosophy of method, in the given case, have been held in close alliance.

Accounting at the Crossroads

Accounting is at the crossroads. Accountants must put aside the eyeshade and strive for a broader base of knowledge of economics and business. They must obtain an intimate understanding of the companies with which they work and the industries in which the companies operate. A business approach to auditing and accounting is essential if the CPA is to make any constructive contributions to our society. Whether we are concerned with large companies or small companies, or whether we are large firms or small firms, we can make a contribution to the affairs of our clients if we will simply get behind the books and get into the business to obtain the necessary facts to make the right decisions. We, as accountants, must recognize the weaknesses which exist in our profession and vigorously support the movement to define objective standards upon which sound accounting principles can be based.

A. Bruce Matthews
The Report, October 1960
Colorado Society of CPA's

An Incisive Look at Some Basic Fiscal Facts of Life, Facts Too Often Overlooked

The Facts of Federal Fiscal Life

By John A. Beckett

This paper will be concerned with some facts of Federal fiscal life which are important to every one of us, not only as professional people, but as citizens as well and will call your attention to some schemes for contravening them. In order for these facts to be understood properly, it is necessary to put the Federal Government in perspective.

There is not just one government in the United States; there are many. We sometimes forget this when we speak of "government." In a democracy one of the characteristics of government is the maintenance of public services which are responsive to local needs and choices. The further we remove the issues of government from the local scene, the greater is the tendency of government to lose its sensitivity to local needs. That is why we have State, county, township, and city governments in the United States. They employ nearly three times as many people as are employed by the Federal Government, and together have been spending between forty and fifty percent as much in recent years as the Federal Government. As a matter of fact, if you exclude military and international expenditures, State and local governments spend more than the Federal Government does. Moreover, State and local governments are growing in size, in complexity, and in consequence. The growth of great metropolitan centers in the United States has been one of the major characteristics of the postwar years, and it is continuing apace, with accompanying issues of social, financial, and other natures.

So when we think of "government," let us not forget that important as the Federal Government has become on the national scene in recent years, and important as it may further become in the years ahead, it is not by any means our only instrument of national development and service to the ever-growing number of citizens in our country. The President time and again has sought to maintain perspective in the public mind with respect to the balance between and amongst these governments.

But back again to some facts of life in the Federal Government, and the issues that lie behind them.

The Leverage of Recession

You will remember that in late 1957 and early 1958 this country suffered a business recession. That recession

was short-lived, but it did affect many people and many businesses.

You may be interested to know that short-lived business recession affected Federal finances. The Federal Government's income from individual and corporate taxes fell off substantially, and at the same time some government expenditures were increased, in part to produce a countereffect to reduced business activity. The net result for the Federal Government was a deficit of 12.4 billion dollars in fiscal year 1959—the largest deficit in the peacetime history of the United States.

The recession which caused that result was, I am sure we will all agree, regrettable. It would be much nicer if it had not occurred. But let none of us infer that this was a sign of economic weakness. We have a strong and resilient economy; it has produced the highest standard of living, by far, of any economy in the world. In spite of all the fear talk of some who interpret an occasional recession as a symptom of grave weakness in our economic machinery, we have an active productive capacity, and an output second to none in the world. That we have—and will continue to have—good and poor years, is no reflection on the basic strength of our economy.

But the point is that the 1957–1958 recession produced a 12.4 billion dollar deficit for the Federal Government in fiscal 1959; as you can imagine, that was a large addition to the already substantial debt of the United States.

Thus, from the above the first fact about Federal fiscal life is apparent. Even a short economic recession can produce sobering fiscal consequences for the Federal Government.

The Size of Surpluses

The fiscal year 1960 showed a surplus substantially above that which had been expected earlier in the year. When the year ended last June 30, we were 1.2 billion dollars in the black. But as gratifying as that was, you can see that it was small indeed when compared with the 1959 deficit of 12.4 billion dollars.

For the current fiscal year—1961—the administration gave to the Congress a proposed budget which would have produced a surplus by July of 1961 of 4.2 billion dollars—the second highest on record. However, the likelihood of achieving any such surplus has been sharply reduced by recent actions of the Congress and its failure to enact some of the President's proposals and reduced expectancies for corporate tax revenues. We now expect a budget surplus of 1.1 billion dollars.

Never in the history of our country have we had a surplus in one year which approached the size of the deficit induced by that single short-lived recession in 1958.

This is the second fact of Federal fiscal life: The best of our surpluses in recent years do not begin to compensate for the revenue losses in times when economic activity recedes temporarily.

Debt and Its Carrying Costs

Annual deficits and surpluses are one thing; the total debt of the Nation—and more particularly the cost of carrying it—is another. At present the United States Government owes about 288 billion dollars to the holders of government securities, and the annual interest expense for carrying that debt is now around eleven percent of the total budget receipts of

the Federal Government anticipated in fiscal 1961, or 9.0 billion dollars.

Put it another way; out of every tax dollar you pay to the government—and personal income tax payments constitute fifty-four percent of all income budgeted for 1961—eleven cents go to meet annual interest costs on those government securities. When you remember that seventy-five percent of the total individual income taxes received by the Federal Government arise from the income brackets under $5,000, you get an even clearer idea of the impact of interest costs on the individual taxpayer.

We pay far more for interest than we do for agricultural price supports or veterans' benefits. In fact, the only government program which costs more than interest on the public debt is major national security, for which we spent—last year—45.6 billion dollars.

I think you will agree that this is a high cost to pay for interest.

This, then, is the third fact of Federal fiscal life: The carrying cost of our Federal Government debt is around eleven percent of our total income.

These three — deficits, surpluses, and debt—describe some of the more apparent realities of Federal fiscal life.

But there are some other facts of fiscal life that are not so apparent. Let's have a look at a few.

"Built-in" Increases of Government Spending

First, there are many programs which are today accepted as normal, necessary, inescapable programs of the Federal Government and which are due to cost much more in the years ahead than they do now. With growing population, increasing urbanization, and accompanying increases in the complexity of social life, some present programs will inevitably increase in cost. Such "bult-in" increases in 1961 alone came to over 2 billion dollars; for 1962, there are already "built-in" increases of over a billion dollars more.

The Government is committed in the future for plenty of other costs. For example:

—Merchant Marine subsidies and ship replacement just for currently subsidized ships will cost 4.3 billion dollars.

—5.4 billion dollars is already committed for future Federal contributions for public housing.

—Federal civil public works projects already started will cost 7 billion dollars after 1961 to complete.

—It may cost as much as 30 billion dollars or more to complete the interstate highway program.

These and other obligations, along with huge unexpended balances in our defense program amount to 100 billion dollars of future commitments.

There are others, too, for which we must pay in the future for obligations already incurred.

—Accrued military retirement amounts to 38 billion dollars, and is not funded.

—Accrued civil service retirement amounts to about 28 billion dol-

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lars above present fund balances.
- —Veterans' pensions, compensation, and other benefits amount to another 300 billion dollars.

All these are obligations we have assumed for past services.

Now if you take the 288 billion dollars of national debt, add the 100 billion of commitments we have made for going programs, and about 370 billion for retirement, pension and benefit programs, you come to the astronomical total of over 750 billion dollars—the size of our national mortgage on the future.

This is not fancy, this is fact; a fact of Federal fiscal life—albeit not a very widely recognized fact—with which it would serve more Americans to be familiar.

Demand for New Programs

Secondly, added to the already built-in growth of Federal expenditures and to the national mortgage, there is an almost insatiable demand for Federal Government activities. There are insistent demands for new or expanded programs in education, housing, reclamation, defense, medical care, research, space exploration; you name it, there are pressures for new programs—without, of course, new taxes.

There is really no way of measuring with any accuracy the total additional cost of satisfying all these demands, but they run up to incredible figures. If you have been sobered by this talk of billions up to this point you would be staggered by the magnitude of the costs which would be wished onto the Federal Government by those who look to it to supply all of what they conceive to be our national needs, and much more than the Federal Government is committed to at the present time.

Summary—Facts of Fiscal Life

In summary these are a few of the hard facts of fiscal life in the Federal Government.

- —Deficits are easy to come by;
- —Surpluses are hard to come by and they do not compensate for the deficits;
- —Debt costs are higher than any other Federal costs save those for defense;
- —We are already committed to spend incredible sums in the future for past services;
- —Higher levels of spending in the future are built into present programs;
- —There are tremendous pressures to get the Federal Government to do still more; and
- —Of course, there is a widespread reluctance to face up to the problem of how to pay for all of it.

These fiscal facts of life are now well recognized by most people who make it a point to study government affairs, and they are beginning to be recognized more and more broadly in the American electorate. Together they pose difficult issues and tough challenges.

Obviously, so long as we are spending more than half of our Government's income on defense, and another eleven percent on just carrying our debt, and so long as we are unable to generate big enough surpluses to compensate for our Federal deficits, there are going to be difficulties in paying for the many things we have already "ordered" and financing the many other things that people would like the Federal Government

to provide—without going further in debt or raising present tax rates.

In the face of all this, we now hear the rising cry that the "public sector" of our economy is being starved, that as a Nation we are spending more on luxuries and less on essentials than we should, and that because of this the Federal Government should accelerate its spending.

This syllogism exposes a remarkable lack of confidence in the free enterprise system and a substantial ignorance of the enormous growth of public services in the past decade, to say nothing of an obvious blindness to the existence and the role of State and local governments. It is a clear indication of the philosophy that Federal Government should assume the burdens of the people, and is in sharp contrast to Araham Lincoln's timeless expression when he said the legitimate object of government is "to do for the people whatever they need to have done, but cannot do at all, or cannot so well do, for themselves—in their separate and individual capacities."

Nevertheless, the pressure for unnecessary Federal Government spending persists.

Economic Growth

It is at this point that the matter of the country's rate of economic growth comes to the fore. For as the economy grows, tax revenues—at the same or even lower tax rates—increase. And that increase in Federal revenues could be used, if not for debt reduction then perhaps to absorb some of the additional costs of added public service. In simple kitchen arithmetic, the Federal Government could have more to spend on the needs of the Nation without adding further to its debt if its income were to increase as a simple function of the increase in economic activity of the Nation—provided, of course, that the added income were more than enough to pay for the commitments that already exist as they fall due in the future.

That's why we hear so much these days about economic growth. And that's why there have been so many proposals recently for forcing the Nation's rate of economic growth to levels which are significantly above the historical rate of about 3 percent.

Now there is every reason for all of us to have confidence in the continuing growth of our Nation at historical or even higher rates. I submit to you, however, that we can no longer afford to continue the popular illusion that the Federal Government is the cornucopia of modern times or that there are readily available magic formulas by the use of which we can have all the benefits and pay none of the costs of an artificially stimulated economic growth rate.

All about us these days we hear proposals built on the assumption that money buys everything—more money will buy adequate defense, an ideal educational system, a solution to the problems of old age, of illness, and of juvenile delinquency. Now we have the proposition that we can spend ourselves into economic growth.

Schemes to insure "forced growth" of the country's economy should be recognized for just what they are—alternatives to sound economic growth.

In thinking of the proposals for artificial stimulation of the rate of growth of our economy, one is somehow reminded of the mass production of chickens on our automated farms.

From the egg to the chopping block, today's production-line chickens live in a controlled environment. They are confined in tiny cages and kept under almost constant light so that they will have time to eat more; they are fed concentrated appetite-stimulating, high-energy food; and they are sold after nine weeks as three-pound broilers.

Here you have an accelerated rate of growth all right. And with more research perhaps it can be even further accelerated—to eight weeks or to seven. Maybe since they hardly have any need for legs any more, the growth of these fowl may even be redirected; ways might be found to discourage their growth of legs and make them more like the "schmoos" of comic strip fame.

As beneficiaries of this "forced growth" in chickens, the American family certainly has nothing to complain about. But it strikes me as significant that such an end product can be produced only at a cost of complete regimentation and the tightest of environmental control. The cost of "forced feeding" to maintain an accelerated rate of growth of our economy is similar in many ways, though it is by no means as apparent.

To achieve acceleration in economic growth of the Nation, it is proposed, among other things, that the Federal Government spend more — generally by more borrowing, of course, rather than by increasing taxes.

On the basis of the fiscal facts of life which have been mentioned up to this point, you can draw your own conclusions as to what such added spending would do to the national debt, the annual cost of carrying it, and the fiscal integrity of our Federal Government. In addition, there are less obvious, but no less important side-effects which could very easily be induced by such "forced feeding" of our economy.

If such additional spending occurs at times when the economy is operating at substantially less than its capacity, the effect of that spending is to reduce unemployment. But if such additional spending occurs at times of close-to-capacity operation in order to accelerate the economic rate of activity, then there is little unemployment to reduce and the most likely effect is higher prices and inflationary pressures. It is at these latter times that the economic growth faddists expect increased Government spending to contribute substantially to an even higher growth rate for the economy!

Actually this is an open invitation to inflation, and must be recognized as such by the American electorate. If we follow the course of "forced feeding" of our economy when times are good we will surely buy the by-products that come with it. As surely as inflation follows "forced feeding," price controls follow inflation. And price controls are the forerunners of other Government restrictions on the freedom of individual choice.

The prospective cost, as in the case of the chickens, is loss of freedom for the individual. And this, I suggest, is too precious a freedom to gamble on losing.

Let us remember that the people of this country have never been exposed to the evil of galloping inflation, and we have known governmental control only to a limited extent in time of war. Yet the peoples of many other countries know these twin thieves of freedom intimately, and they are quick to warn us that these are perils

to be soberly considered as we chart the course of our Nation in the years ahead.

No one should assume that this could not happen here.

Let me put this point another way: If from this meeting you chose to drive home as fast as your car would take you, your chances of getting there intact would be reduced very substantially over your chances of getting there at reasonable speed, taking into account the hazards of the road. At forced draft you might make it all right; and in getting there earlier you might enjoy an advantage over your neighbor. But in doing so you take unto yourself the potential of disaster along the way.

In the case of the individual, his failure to make it home would be a tragedy; in the case of the economy of the United States it would be sheer catastrophe. Taking such risks with the economy of the United States is nothing short of playing Russian roulette with the future of our country.

The sooner we recognize the potential side-effects of forced economic growth—inflation and regimentation—the sooner will the American electorate insist on a sound course of economic growth for our country. To do otherwise is to gamble the whole future of the Nation for some questionable benefits in the short run. Conservative growth may have some disadvantages, but this, I submit, is the *cost of freedom*.

Conclusion

There has been much loose talk about the Federal budget which exposes these facts of life—that it has thwarted the achievement of national goals and inhibited the growth of our Nation. The all-too-common vision of the fiscal conservative is commonly contrasted with that of the so-called liberal who is conceived to be the embodiment of bold, forward thinking.

Do not be misled. The financial strength of our Nation is indispensable to our confidence in ourselves, and to our position as a leader amongst nations of the world. We could do the Russians — who have vowed to bury us economically—no greater favor than to sap the initiative of individuals and dissipate our national strength through faulty economic practices leading to inflation and Government controls. It is the conservatives who are attempting to preserve the fiscal integrity of the Federal Government, and if that point of view lacks glamour, it at least has the comfort of being on the side of the right. Consider this carefully as you appraise the proposals of the so-called liberals: there is no tolerable alternative to conservatism in Federal finance.

Essential Features to be Included in a Partnership Agreement for a Public Accounting Firm

Partnership Agreements for Public Accounting Firms

By Jackson L. Boughner

Every year witnesses the formation of new partnerships among Certified Public Accountants and the growth of existing partnerships. Before discussing the agreements themselves let us consider the purposes for which partnerships are formed and the advantages gained thereby. The partnership agreement should be so drawn as to make certain that all of the desired results are obtained.

Any combination of two or more accountants will result in reduced expenses. In addition to the savings in rent through a more economical division of the space, there are savings in stenographic and typing help. Accountants who have juniors working for them are concerned with the fact that at times the juniors are overworked and at other times they are idle. The formation of a partnership will smooth out these peaks and valleys.

In addition to saving expenses, the formation of a partnership may result in an increase in gross income. This will be true when a sufficient number of accountants are involved so that one or more can specialize. At present the two fields in which many accountants operating alone feel that they are deficient are those of income taxes and systems. In a partnership of three or more accountants, one can specialize in income tax matters. During the busy season he will be preparing individual and corporate returns and reviewing returns prepared by his partners. After the busy season he can engage in tax planning and handle the audit of returns by revenue agents. By designating him as the tax expert, fees can be increased and tax matters can be more expeditiously and satisfactorily handled.

Many accountants watch their smaller clients grow larger and then go off to another accounting firm where they can get a complete revision of their costs and bookkeeping systems. The first danger signal is when the client says that he is not getting sufficient information out of his accounting records. The average accountant practicing on his own is in no position to keep abreast of all the developments in costs and systems. However, in a larger partner-

ship one man can specialize in these matters. When a client indicates that he is interested in a new cost or bookkeeping system, this partner will be available for the work.

Another advantage in being in a partnership is that it enables the accountant to take an uninterrupted vacation. With the present necessity for monthly reports and returns, many accountants find it almost impossible to take more than a few days away from the office at a time. In a partnership they will be able to take much longer vacations, secure in the knowledge that their clients' affairs are being handled.

Finally, one of the principal reasons for the formation of partnerships involves the disposition of the practice on retirement or death. An accounting practice has a definite capital value. An accountant who has gross billings of $50,000 a year, may consider that he has an accounting practice which is worth $50,000. Or he may apply a factor of five times the net income to arrive at its value. If he continues to operate as a sole proprietor until his death it is exceedingly unlikely that his estate will realize anything near that amount. However, if, while at the height of his career, he forms a partnership with a younger man, he can arrange for the payment to him of the full capital value over a period of years without impairing his ordinary income. This payment will be made even though he should die before having received it in full. Every accountant who is practicing alone and who has attained the age of 55 years should give consideration to the fact that within approximately ten or fifteen years he may well be unable to maintain his practice at its present level. He should consider joining a younger man with him in a partnership to preserve this value for himself and his estate.

The appendix to this article contains a suggested form of partnership agreement between certified public accountants together with optional clauses. Every clause now appears in the partnership agreement of some public accounting firm in the State of Illinois.

Functions of Agreement

A partnership agreement among accountants has two principal functions. The first is to define the rights and duties of the partners during the existence of the partnership. The second is to define the rights of the parties at the time the partnership terminates in whole or in part through the death or withdrawal of one or more members.

The Uniform Partnership Act is in force in Illinois. All partnership agreements, whether for accountants or for others, should be written with the provisions of this Act in mind. Section 24 defines the property rights of a partner as (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) the right to participate in the management. Section 26 states that a partner's interest in the partnership is his share of the profits and surplus.

The capital interest of a partner, for income tax and accounting purposes, will almost always be the same as his interest in the partnership property under partnership law. The distributive share of the income of a partner for income tax and accounting purposes will almost always be identical with his share of the profits as that term is used in Section 26 of

the Uniform Partnership Act. The differences arise in situations where income tax accounting differs from business accounting. Generally speaking, therefore, the financial reports of a partnership will reflect the legal property interests of the partners in the partnership property and profits.

Sections 1 through 4 of the recommended form deal with the fiscal year, the method of accounting, the opening balance sheet and the capital contributions. The opening entries on the partnership books should reflect this information.

Division of Profits

Section 5 calls for a division of profits on a percentage basis. However, there are optional clauses under which a partner can be credited with interest on his capital account, can receive a salary, can receive commissions on new business, and can receive his share of the income on some basis other than a percentage basis. Accountants starting out as partners for the first time may have some question as to how they should allocate the income between them. The simplest method, of course, is for each to keep his own set of records, collect his own income and pay his own expenses. Items of shared expense can be allocated by agreement. Rent can be allocated on a square foot basis. Paper and other supplies purchased can be charged to a partner as he withdraws them from the common stock. The time of office and accounting personnel can be divided on the basis of the number of hours worked for each partner. If two men are starting out in partnership for the first time, it might be well to adopt a method of this type rather than going into a complete partnership. Then, after they have operated together for a while and know more about each other they may be able to put their practices together on a more firm basis.

A modification of this method is for the partnership records to show separately the total billings of each partner and then to allocate the expenses on the basis of gross billings. This assumes that the partner who bills the most during the year makes the greatest use of the partnership facilities.

The development and maintenance of an accounting practice is dependent upon two factors. The first is the ability of the accountant to attract clients. The second is the ability of the accountant satisfactorily to perform the work for the clients. Each of these factors should be taken into account in determining the division of profits.

Two accountants can compare their earnings for the past five years and determine that out of the total one has produced sixty per cent and the other has produced forty per cent. They may then decide to form a partnership with one getting sixty per cent and the other forty per cent. This would be a formula based entirely on the past, giving no consideration to what may happen in the future.

Such a clause gives no credit for new business brought into the partnership. The forty per cent partner may bring in and handle himself several fine accounts but will still get only forty per cent of the income

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from them. For this reason one of the optional clauses deals with commissions on new business. Although the percentage is left blank, it is recommended that the commission be at least ten per cent and that the hourly rate be at least seventy-five per cent of the standard hourly rate. It might well be advisable to insert a sentence in this clause under which these commissions would cease after the client has been served by the partnership for seven years.

A straight sixty-forty division of the profits also does not take into account the amount of work which each partner is to perform. Prior to a division of the profits, each partner should be credited with a salary commensurate with the amount of time that he is going to put into the partnership business. Then, if the partnership should fall on hard times, the partner with the lower percentage will not suffer nearly so much since he has his basic draw to rely on. The agreement might provide that every partner shall receive the same fixed salary and that only the profits in excess of this amount shall be divided. This makes sense because every one should first be paid for the time he puts in.

The worst mistake that a new partnership can make is to leave out the clause relating to the division of profits. There are certain accounting firms in the State of Illinois that have no such clause in their partnership agreement. It is their thought that at the end of each year the partners can all sit down and agree as to how the profits should be distributed. It is difficult to see how, if the partners cannot agree on a division at the time they enter into partnership, they will be in any better position after they have worked together for a period of time.

If the agreement as to the distribution of profits requires the consent of every partner, a serious deadlock can occur if one partner feels that he is not receiving enough and holds up the entire distribution. On the other hand, if the distribution requires the consent only of a majority of the partners, one partner could well be cut off with little or nothing for the year if his partners took a dislike to him. If the agreement also contains clauses preventing a partner who has left the firm from competing against it, such a partner may be in a very dangerous position.

It should be borne in mind that any clause in the partnership agreement can normally be amended by a majority in interest of the partners. Therefore, at the beginning of each year, there should be a formula in the partnership agreement providing for the manner of distributing the profits. During the year, if a partner should die or retire, this clause will operate to make certain, from a legal standpoint, exactly what his share of the earnings are up to the date of death or retirement. At the end of the year then, if the partners wish, they may by agreement among them change the formula to one which they feel is more equitable.

Under some partnership agreements, the clause setting forth the distribution of profits cannot be amended except by agreement of more than a majority. For example, depending upon the number of partners and their partnership interests, it might be provided that at least two-thirds or three-quarters of the total partnership interests must agree before such a change can be made.

Sections 6 through 11 are somewhat standard clauses which should be in every partnership agreement. In sec-

tion 11 there appears for the first time a reference to the determination of the share of a partner for less than a full year. Rather than make a complete accounting cut-off on the date of expulsion, death, or retirement, wait until the end of the year. Then divide the profits between the partner who has left or died and the remaining partners on a time basis. Thus, a partner who dies, retires or is expelled at the end of six months of the fiscal year, would receive one-half of his normal share of the full year's earnings.

Retirement Payments

Section 12 provides that upon termination of a partner's interest he shall receive his capital account, his undrawn earnings, and his pro rata share of the earnings for the year. In the proposed agreement we have not gone any further in providing for retirement payments. However, one of the optional clauses provides for payments subsequent to retirement determined by applying a fraction of his last profit sharing percentage to future earnings. As an example, he might receive one-fourth of his prior percentage interest for a five or ten year period depending on the size of the partnership and its ability to continue these payments. We have purposely avoided any clause under which the payments to the retiring partner constitute good will, since although he is thereby benefited by paying the tax at half the normal rate, the remaining partners will get no deduction for the payments. The retiring partner will usually be in a much lower bracket than the remaining partners and the only winner under such an agreement is the Federal government. It is better to continue the payment to the retiring partner a little longer in order to make up for the additional tax he pays by receiving it at ordinary rates.

The basic agreement contains no clause under which the work in progress of the partnership is considered in determining the interest of a deceased or retired partner. Legally, such a partner is entitled to receive his share thereof. It is felt that by permitting him to share in the earnings at a reduced rate for a period of time, he can be compensated for this without injecting difficult problems of valuation into the picture. Some partnerships carry life insurance on each of the partners in an amount sufficient to cover this. If the deceased or retired partner is not to share in future profits on a percentage basis, the agreement should spell out exactly how the surviving partners shall continue the business and pay the deceased or retired partner his pro rata share of the work in progress, when collected. If adequate time records are maintained, it may be possible to value it by direct reference to them.

The clause proposed in the optional clause for retirement differs greatly from that presently in the partnership agreement of many of the large accounting firms. These partnership agreements were originally drafted long before the income tax became the problem it now is and have been continued primarily for historical reasons without consideration being given to their economic and tax effects. These agreements provide that when a partner is taken into the partnership he acquires percentage points from another partner who is in the process of retirement. This new partner pays to the retiring partner a certain amount for his interest in the

tangible and intangible assets of the partnership. After this new partner has all of his points acquired he will shortly start retiring himself and will receive from another partner payment for these points. The payment that he receives he can treat as a capital gain and will be reported at half the ordinary rate.

These provisions have probably forced more desirable young men out of public accounting and into work for private industry than any other factor in the accounting profession. Let us take the example of a young man who has reached the senior or supervisor level in a large public accounting firm. He is receiving a salary of $12,000 a year and is offered a partnership. We will assume that his starting percentage is two per cent. The tangible assets of the firm, including its cash, accounts receivable, work in process, etc. amount to $500,000, and he is expected to pay $10,000 for his share of these. He will give his note for $10,000 payable over a five year period at the rate of $2,000 a year. The net profits of the firm, over and above the salary or drawing accounts of the partners, have amounted to $200,000 annually. This is used to determine the value of the intangible assets of the firm. Capitalized at twenty per cent it produces a total intangible value of $1,000,000. The two per cent interest being obtained by the new partner is, therefore, worth $20,000. He will pay this amount over a ten year period at the rate of $2,000 a year.

We find therefore, that the new partner will have an income of $16,000, being his $12,000 basic salary, plus $4,000 of profits (two per cent of $200,000). This obviously, looks much better than the $12,000 he has been earning. However, out of this $16,000 he must, for five years, pay $2,000 for the tangible assets of the firm and, for ten years, $2,000 for the intangible assets. The net result is that for the first five years, ignoring the income tax, he will still be making his basic $12,000. If our young partner to be is not aware of the income tax consequences of joining this partnership he may feel that the prestige of being a partner more than makes up for the fact that he is frozen at his present pay for a five year period. However, if he has available a copy of the income tax rates he soon sees that it is not so favorable.

Let us assume he is married and has deductions and exemptions of $2,000. On his basic salary of $12,000, he will pay a tax of $2,200. On $16,000 he will pay a tax of $3,920. Before he became a partner, his take home pay was $9,800 ($12,000 less $2,200). After he becomes a partner, his take home pay will be $8,080.00, a net reduction of $1,720.00 a year. At the end of the first five years, when he will have paid for his tangibles, he will find that he has realized a net increase in take home pay over and above his employee days of $280.00.

Most of the top employees in accounting firms are well aware of this situation. They have heard the junior partners complain that after they became a partner their living expenses went up because of the requirements of the position and their income went down. A young man is making $12,000 a year with a public accounting firm. He is offered a partnership which will produce a net reduction in pay of $1,720 a year. A client offers him a comptrollership at $15,000 a year. Is there any question as to what his next step will be?

There is no need to require a new partner to pay for a share of the capital account. The other partners can continue to leave their share in the partnership and receive six per cent interest. If the new partner has the funds he should be encouraged to contribute them to the partnership because this six per cent will come off the top and leave him that much less. Every partner should have the right, of course, to withdraw his entire capital account upon death or retirement. At that time, under section 4 of the suggested partnership agreement, all of the partners can be required to make an additional capital contribution. The requirement, therefore, that a new partner immediately start paying for a capital interest in the partnership is completely unnecessary. The older partners are in a much better position to advance funds and enjoy the six per cent interest on them than is the younger partner who is probably more concerned with raising and educating a family.

Payment for Intangibles

Nor is it at all necessary that a new partner pay to an older partner immediately upon admission and for several years thereafter any amount for the intangible value of a partnership interest. Instead, retire the older partner when he has reached the end of his usefulness and pay him as ordinary income over whatever time is necessary an amount equal to his capital interest plus the increased tax occasioned by the fact that he cannot apply capital gains rates. Under such circumstances the remaining partners can deduct as an ordinary expense of operation the amounts being paid out. In the optional clause the amount to be paid the retiring partner is based upon a percentage of the income earned by the partnership during each year the payments are to be made. This is advantageous to the remaining partners since if business falls off, the amounts they will pay to the retired partner will also fall off. At the same time, it contains advantages for the retiring partner since if we come into a period of inflation during which accounting fees and prices go up substantially, his payments will increase.

However, if the partners desire, the amounts to be paid the retiring partner can be determined in other ways. You may use a percentage of the average earnings of the partner himself for a certain period of time prior to his retirement. You may use a definite sum each year. In either event the amount paid out will be treated as income to the partner and deductible by the remaining partners,

When an accountant with an established practice takes a young man into partnership with him it is possible for a goodwill item to be placed on the balance sheet and a corresponding amount added to the capital account of the senior partner. The agreement can provide that over a period of time the junior partner will pay certain amounts into the partnership which will be credited to his capital account and which will be paid out to the senior partner. So far as the senior partner is concerned, until he has received in full his original tax basis for his interest he will have no tax to pay. Thus, assume the cash, furniture and fixtures and other items on the books at the time of the formation of the partnership may amount to $15,000. This amount, as paid in by the junior partner and withdrawn by the senior partner is

nontaxable to the senior partner. At such time as the tax basis of his partnership interest has been recovered, additional withdrawals by the senior partner will be taxable at capital gains rates.

Over a period of time the capital accounts of the two partners can be equalized in this manner with a minimum of tax penalty. Such a clause in the partnership agreement can be tied in with a higher percentage for the junior partner to provide him with funds to make the pay out. Since the junior partner is normally in a lower tax bracket than the senior partner, it is less expensive to add $5,000 a year to his income, let him pay the tax on it and then contribute it to the partnership than to have the senior partner draw that $5,000 out as ordinary income. See the optional clause entitled "Equalizing Capital Accounts."

Miscellaneous Provisions

When a partnership is formed between an accountant with an existing substantial practice and a younger man it is sometimes necessary to put in a protective clause giving the senior partner the right to get his practice back upon dissolution. An optional clause so providing is given in the appendix. If the capital account of the junior partner has been built up by giving him an additional share of income it may not be equitable to give him his entire capital account. Under such circumstances the agreement can provide that he would be entitled to ten per cent of his capital account if he leaves after one year, twenty per cent after two years and so on. See the optional clause covering this.

It is advisable, if any or all of the partners do any amount of entertainment for the purpose of acquiring new clients, that these expenses be reflected on the partnership books rather than on the individual returns of the partners. There has been a growing tendency on the part of the Internal Revenue Service to disallow business expenses claimed on individual returns on the theory that such expenses should be paid by the business itself. If the partnership agreement contains a provision calling for the payment of commisions on new business obtained by the partners, consider having these expenses, when reimbursed by the partnership, charged directly against the commissions account rather than against the ordinary operations of the partnership. This will eliminate any disputes among the partners as to the amount of entertainment by the various partners since the amounts will, in effect, be charged directly against the partner's share of the earnings rather than against partnership operations as a whole.

In some cases a partner in an accounting firm may take a part time or full time salary position while still remaining a partner. It may be that he has left with the firm a substantial clientele and that when he ceases his salaried employment he will wish to return to the firm and take up the practice of accounting again. Under such circumstances, in determining the net income of the firm, it would be proper to add to the income on the books the salary received by this partner. Then the regular partnership percentages are applied against the total figure and the partner's salary is charged against his drawing account. Only the excess over his salary would be considered as payable to him.

In determining the percentages to be paid to a retired partner or a deceased partner's estate, consideration can be given to the number of years that he has been with the firm and to the amount of business that he has brought in. Thus, if three men form a new partnership and the bulk of the business has been brought in by one man, the partner who has provided the main source of the business might receive initially the maximum retirement percentage. The other partners might be placed on a sliding scale so that at the end of, say, five or ten years they will come up to the same percentage as the other partner. Let us assume a three man partnership which basically provides for a three way division of the income. Let us further assume that they have agreed that eight per cent (roughly ¼ of their present 33⅓ per cent interests) should be paid to a retired partner for ten years following retirement. The partner providing the main source of the business would receive his eight per cent immediately regardless of how soon after the formation of the partnership he retired or died. The other two partners might, however, not receive a full eight per cent if they died or retired during the first five or ten years of their membership in the partnership. Thus they might receive a three per cent interest during the first five years, a six per cent interest during the next five years and then be entitled to the full eight per cent interest after they had been with the partnership ten years.

In smaller partnerships there is the danger that if one partner retires and the retirement payments are substantial, the other partners may decide to dissolve the partnership and go their respective ways rather than continuing the payments. If such a possibility is envisioned, there should be a clause in the partnership agreement to the effect that if the partnership shall be terminated when there are any payments due to a retired or deceased partner, each of the then partners shall be jointly and severally liable for the payments if they continue in the practice of public accounting. Under such circumstances, if the retired partner is to receive a percentage of the earnings after he retires, that percentage should be applied directly to the income of any former partner who has continued in the practice of public accounting after the partnership terminated. An optional clause along these lines is provided.

Many accountants carry insurance offered by the American Institute of Certified Public Accountants. In some agreements it is provided that the payments for this insurance shall be made by the partnership out of partnership funds. Under such circumstances a clause should be inserted in the agreement indicating that the proceeds of such insurance shall be applied to reduce the capital amount due the deceased partner and paid directly to the widow. A clause providing for this treatment is appended.

In order to avoid the problems that arise when a partner is absenting himself from the business for longer than normal, there is proposed a clause dealing with adjustments for absences. Each partnership must determine for itself how many days of vacation each partner is entitled to take and how much sick leave he is entitled to take before he will be penalized. Assuming that the partnership work week consists of five days, there would normally be ap-

proximately 255 working days in a year. If the time off for sickness and vacations amounted to 55 days, a partner would not be penalized for excessive absence under the proposed clause unless he put in less than 200 days a year.

If in clause (e)(1) we insert .2% for each day off, a partner who is absent for sickness the entire year will receive approximately sixty per cent of his normal share of the earnings. If we insert .3% in that paragraph he will receive approximately forty per cent of his earnings, and if we insert .4% he will receive approximately twenty per cent of his normal earnings. The percentage factor to be placed in this paragraph, therefore, depends on the extent to which the partners wish to penalize a partner for absence from the business. If a partner is sick for an entire year he will still need funds and for that reason a factor of .2% is recommended. Note that if he has been totally and permanently disabled for a six month period, he can be involuntarily retired from the partnership at which point his retirement payments will start.

Conclusion

Certified Public Accountants, in preparing their own partnership agreements, should approach the problem with the same care that they use for their clients. The main purpose of the agreement is to prevent disputes during the existence of the partnership and upon its termination. The principal disputes are financial in nature; the division of the earnings during operation and the payment for the capital value on termination. The partnership agreement, to be worth the paper it is written on, must contain clear and concise clauses covering these two situations. The income tax consequences as well as the legal consequences of every clause should be considered. We would not like to see a client enter into a partnership with no provision for the distribution of the profits and no provision for division of the assets upon liquidation. There is no reason why we should burden ourselves with that type of agreement.

APPENDIX

PARTNERSHIP AGREEMENT

This partnership agreement made this ______ day of ____________, 196__, between (names)

WITNESSETH:

Whereas, the parties hereto desire to associate themselves as partners in the practice of public accounting under the firm name and style of ____________________.

NOW THEREFORE, in consideration of the covenants herein contained, it is agreed by and between the parties hereto as follows:

1. The parties hereto shall, as partners engage in the practice of public accounting from the date hereof until ______________, and from year to year thereafter, unless this agreement shall be terminated in the manner hereinafter provided. They shall conduct their practice in accordance with the rules of professional conduct of the Illinois Society of Certified Public Accountants and the American Institute of Certified Public Accountants.

2. The fiscal year of the partnership shall be the twelve-month period ending as of ____________________, and each year thereafter. The books of the partnership shall be kept on the cash receipts and disbursements method of accounting.

3. The assets and liabilities of the part-

nership shall be, in the beginning those shown upon the balance sheet of the partnership dated ______________, attached hereto and made a part hereof as exhibit "A." All liabilities shown thereon shall be and are hereby assumed by the partnership.

4. The initial capital contributions of the respective partners shall be those shown upon the balance sheet dated __________, attached hereto as exhibit "A." Said capital contributions shall be left with the partnership during the time the contributing partner is a member of the firm. Any additional capital that shall be deemed necessary from time to time for protecting, furthering or enlarging the business of the firm shall be contributed by the then members of the partnership in the proportions in which such partners are then entitled to share in the profits of the partnership.

5. The net profits of the business shall be computed by deducting from the gross income received, the total expenses of operation, excluding any amounts paid partners as drawing accounts. Net profits shall be divided and net losses borne in the following percentages: A___%: B___%: C___%.

6. (a) The parties hereto shall be entitled to draw monthly against the net profits of the partnership so credited to their respective accounts, such amounts as may be fixed from time to time by a majority in interest of the partners. All net profits of the partnership credited to the accounts of the respective partners in excess of the amounts withdrawn shall stand to the credit of the respective partners, in an account entitled "Undistributed Profits," subject to withdrawal at any time by agreement of a majority in interest of the partners.

(b) Upon the death, retirement, or expulsion of a partner, his earnings percentage shall be divided among the remaining partners in accordance with their then percentage interests, unless a majority in interest shall decide otherwise.

7. Every partner shall at all times:

(a) Pay and satisfy his own personal debts;

(b) Devote all his time and attention to the business of the partnership;

(c) Inform the others of all work for and transactions on behalf of said partnership;

(d) Neither assign, mortgage, nor sell his share of the partnership, nor any part thereof, or enter into any agreement as the result of which any person, firm, or corporation may become interested with him therein, except as herein provided;

(e) Endorse no notes or become surety or guarantor for any person or persons upon any obligation whatsoever, except in relation to partnership business, after first obtaining the written consent of a majority in interest of the partners.

8. No partner shall, without the consent of a majority in interest of the other partners, on behalf of the firm:

(a) Make, execute, deliver, endorse, or guarantee any commercial paper, nor agree to answer for, nor indemnify against any act, debt, default, or misconduct of any person or partner;

(b) Assign, transfer, pledge, compromise, or release any of its claims or debts except full payment, or arbitrate, or consent to the arbitration of any of its disputes or controversies;

(c) Make, execute, and deliver any assignments for the benefit of creditors or any bond, confession of judgment, chattel mortgage, indemnity bond, surety bond, or contract of sale or contract to sell its entire personal property or any other contract under seal whether similar or dissimilar to any of the foregoing;

(d) Hire, lease, purchase, or sell or mortgage any real estate, or interest therein, or enter into any contract for such purpose;

(e) Hire, or agree to hire, any person or persons for a definite period in excess of one month, or discharge any person or persons who shall have been hired for a definite period in excess of one month;

(f) Engage in any dealings or transactions with any person or persons, partnership or corporation who any of the then partners have previously in writing requested him not to trust, deal with, or transact business with.

9. Full and acurate accounts of all transactions of the partnership shall be kept in proper books of account, and every partner shall enter or cause to be entered therein a full and accurate account of all of his transactions on behalf of the partnership. Said books of account shall be kept at all times in the place of business of the partnership, or if there shall be more than one such place of business, shall be kept in the principal place of business of said partnership; and each partner shall at all times have access to and may inspect and copy any and all said records.

10. An account or accounts in the name of the partnership shall be maintained in such bank or banks as a majority in interest of the partners may from time to time select. All moneys and funds of the partnership, and all instruments for the payment of money to the partnership, shall, when received, be deposited in said bank account or accounts, and all checks, drafts, and orders upon said account or accounts shall be signed in the firm name by any of the partners. A safe deposit box may be kept in the firm name if a majority in interest of the partners shall so elect; and access to such safe deposit box shall be permitted upon the signature of any of the partners. Adequate and complete accountant's liability insurance shall be maintained at all times.

11. (a) If any partner shall, in the opinion of a majority in interest of the partners, be guilty of misconduct of such character as to render it impracticable for the then partners to carry on the partnership business together, the offending partner may be expelled from the partnership.

(b) There shall thereupon be paid to the expelled partner, or his nominee or representative, the balance in his capital and undistributed profits accounts, as of the beginning of the fiscal year in which such expulsion shall occur, less any withdrawls therefrom, or charges or losses therein, to the date of expulsion.

(c) As of the close of the fiscal year in which such expulsion occurs, there shall be paid to the expelled partner, or his nominee or representative, his pro rata share of the income of that fiscal year, based on the ratio of number of days prior to expulsion to the number of days in the fiscal year.

(d) The interest of the expelled partner in the partnership property and earnings shall cease as of the date of expulsion. He shall thereafter have no rights against the partnership or the remaining partners as to the property or earnings except as to the payments set forth above.

12. Any partner may retire from the partnership as of the end of any calendar month, after giving the other partners at least 60 days' notice in writing of his intention so to do. Any partner who shall be disabled so that he cannot perform his duties as a partner for a continuous period of six months may be retired from the partnership, by a vote of a majority in interest of all other partners, as of the close of the month in which such six months period ends. Any partner who shall be adjudicated a bankrupt, or who shall make an assignment for the benefit of creditors, may be retired from the partnership, by vote of a majority in interest of all other partners. In the event of the retirement or death of a partner, neither the partnership nor its fiscal year shall be terminated and the remaining partners shall continue the business, and shall succeed to the interest of the retired or deceased partner by paying to him or his representative the then balance in his capital and undistributed profits account, and his pro rata share of the income of that fiscal year based on the ratio of the number of days prior to death or retirement to the number of days in the fiscal year.

13. Payments of capital and undistributed profits account balances, and of the share of the current year's income, shall be made
.... percent (........%) within
............days after the end of the fiscal year in which retirement, expulsion or death occurs, and the balance in ....
equal monthly installments until paid in full.

14. A majority in interest of the partners may dissolve the partnership at any time with or without cause, and upon such dissolution, divide the assets among the partners in accordance with their proportionate interests therein. Upon dissolution of the partnership under the provisions of this paragraph, a majority in interest of the partners may continue the partnership business and may use the name and may rent the present premises. In the event of dissolution under the provisions of this paragraph, or death or retirement of a partner under the provisions of the preceding paragraphs, the value of all assets shall be considered equal to the value of such assets as carried on the books of the partnership.

15. All questions relating or pertaining to the conduct of the partnership business, unless otherwise herein provided, shall be determined by a vote of a majority in interest of the partners. An annual meeting of the partners shall be held on the first Monday in .... of each year, at which the first order of business shall be to consider and approve any changes in paragraph 5 hereof, relating to the division of profits and losses among the partners.

16. Any partner who shall violate any of the terms, conditions and provisions of this agreement shall, in addition to being subject to other remedies, liabilities and

obligations herein imposed upon him therefore, keep and save harmless the partnership property and shall also indemnify the other then partners from any and all claims, demands, and actions of every kind and nature whatsoever which may arise out of or by reason of such violation of any of the terms and conditions of this agreement.

17. This agreement shall be binding upon the heirs, executors, administrators and assigns of the parties hereto.

IN WITNESS WHEREOF, the parties hereto have herunto set their hands and seals the day and year first above written.

....(SEAL)

....(SEAL)

....(SEAL)

OPTIONAL CLAUSES

Distribution of Income

(a) Each partner shall be credited with interest at ....% on the average balance in his capital account during the year, based upon the balances as of the end of each month during the year.

(b) Each partner shall be credited with a salary of $.................................. per annum.

(c) Each partner shall be credited with his commisions, as determined under paragraph ....

(d) The balance of the net profits, if any, shall be credited, and the amount of any net loss, if any, shall be charged to each partner (in the following proportions):

....%

....%

....%

(in accordance with his percentage interest for the year, determined by dividing the total amount of fees collected from clients billed by him, by the total amount of fees collected from all clients of the partnership, during the fiscal year then ended).

Commissions for New Business

(a) Commissions as hereinafter determined shall be paid each partner who shall procure new business hereafter through his own personal efforts or through contacts acquired through his own personal efforts. On new business procured by the respective partners there shall be paid to the partners procuring such business a commission of ....% of all revenue received from such business.

(b) The percentage commission rate above provided for shall apply only in the event fees from the business procured equal or are more than the time spent in performing services for the client in question at a rate of $.................... an hour.

(c) Should the receipts for services rendered be less than at the rate of $............... an hour, the percentage of commission shall be reduced accordingly. Amounts due partners for commissions on new business will be credited to partners' accounts only upon actual receipt of payment for services rendered. Commissions on all new business shall be approved prior to payment by a majority in interest of the partners.

(d) Upon the expulsion, death or retirement of a partner, commissions payable to such partner shall cease, except for commissions accrued thereto, and thereafter the entire receipts for services rendered to any client falling within the definition of new business, as herein provided, shall be treated as ordinary income of the partnership in determining the profits, without deduction for commissions.

Adjustments for Absence

(a) Partners shall devote full time to the business. Any partner who, during a fiscal year, devotes less than full time to the business, not including allowable time off as described below, shall have his partnership interest decreased, and that of the other partners increased, as prescribed hereinafter. Such reduction shall be effective only as to the earnings of the year in which it occurs, and shall not be effective as to any fiscal year following the expulsion, death, or retirement of the partner involved.

(b) Time off consists of voluntary vacations and sick leave. Time spent in entertaining or developing contacts with clients or prospective clients, and traveling time when on partnership business shall be considered as working time. Saturdays, Sundays, and any day on which the partnership office is officially closed, shall not be considered as either working days or time off.

(c) Each partner is expected to take at least .... days vacation during each fiscal year of the partnership, and each is permitted .... days vacation during each fiscal year without adjustment of earnings. Each partner is expected to arrange his vacation periods so that a minimum burden will be placed on the other partners. If fewer than .... days vacation are taken

by a partner in any fiscal year, he may carry forward the unused days to future years, subject to the following restrictions:

(1) No carry-over shall be made for periods prior to ....;

(2) The carry-over from any one year may not exceed ....days;

(3) The total cumulative carry-over may not exceed ....days.

(d) Sick leave is time off for reasons of the health of the partner or because of illness or death of a relative. Each partner may take .... days sick leave in any fiscal year without an adjustment of earnings. Additional sick leave days may be obtained by a corresponding reduction in vacation days in any fiscal year, but unused sick leave is not to be available for additional vacation. If fewer than .... days sick leave are taken by a partner in any fiscal year, he may carry forward the unused days to future years, subject to the following restrictions:

(1) No carryover shall be made for periods prior to ....;

(2) The total cumulative carry-over may not exceed .... days.

(e) Each partner shall make semi-monthly reports to the partnership of the number of days he has taken for (a) vacation, and (b) sick leave. From such reports, each partner's total vacation days and total sick leave days for the fiscal year shall be determined. In each case where a partner's total vacation days or total sick leave days exceed the permissive number, an adjustment of the partner's earnings shall be made as follows:

(1) Such partner's share in the partnership earnings shall be reduced by ......% thereof for each day off in excess of the permissive number. The amount of such reduction shall then be credited to the other partners in proportion to their profit-sharing ratios;

(2) In case two or more partners have an excessive number of days off, the computation of each such partner's reduction shall be based on his original share of the firm's earnings (before adjustment for any other partner's excess days off).

Payments Subsequent to Retirement

Each retired partner, or his estate in the event of death after retirement, except as provided in paragraph .... hereof, and the estate of each deceased partner, shall, in consideration of past services, receive a share of the earnings of the partnership for that year and subsequent years, determined as follows:

(a) Each such retired partner or deceased partner's estate shall receive, as of the close of the fiscal year in which death or retirement occurs, a percentage of the earnings, which percentage is the sum of the following:

(1) One-twelfth of his last profit-sharing percentage, multiplied by the number of months from the beginning of the fiscal year to the end of the month in which death or retirement occurs; plus

(2) One forty-eighth of highest profit-sharing percentage, during the previous 5 years multiplied by the number of months from the end of the month in which death or retirement occurs, to the end of the then fiscal year.

(b) Each retired partner or deceased partner's estate shall receive, as of the close of each fiscal year succeeding that in which his death or retirement occurs for ....years, a percentage of the partnership profit sharing percentage during the previous five years. Said .... year period shall be reduced by one for each year he lacks of age 65 or retirement, and further reduced by one month for each full month during the previous five years during which he was absent for disability.

(c) If a partner shall retire at any time other than as of the close of a fiscal year, the number of years during which he may participate in the earnings, as set forth above, shall be .... If a retired partner competes with this partnership in any way after the close of the fiscal year in which he retires, but prior to the end of the fiscal year in which the last payment to him under paragraph............ above, is due him, he shall forfeit all payments for the fiscal year in which such act occurs, and all subsequent years, but shall not be required to return any advances made to him against earnings of such year.

(d) Payments of shares of the earnings for years subsequent to death or retirement shall be made within 60 days after the close of each such year, except that there may be loaned to a retired partner or the estate of a deceased partner, on June 1, September 1, and December 1 of the years following the first full year after retirement or death,

amounts equivalent to 20% of the total amount received during the previous year, adjusted to conform to the percentage interest for the current year.

(e) A retired partner, so long as he is receiving payments hereunder, shall not at any time perform work for any client or clients of the partnership, and shall not at any time disclose to any person, firm or corporation the name or names of any client or clients of the partnership, or of any of its transactions, nor at any time use the firm name by itself nor in conjunction with his own name or otherwise, nor use the words "formerly of ...." nor any other combination of words containing the firm name.

Dissolution of Firm Before Retirement Payments Completed

In the event this partnership should be terminated under the provisions of paragraph .... above and there shall be due to any retired partner or to the estate of a deceased partner payments under paragraph .... hereof, it is understood and agreed that if any of the partners at the time of such termination shall continue in the practice of public accounting, they shall be jointly and severally liable to such retired partner or estate of a deceased partner for the amounts still due under said paragraph .... In such event the percentages provided for in said paragraph .... shall be applied to the earnings of such retired partner or partners from the practice of public accounting whether carried on as an individual, or in partnership with others.

Life Insurance

In the event the partnership should take out insurance on the life of any of the partners, the proceeds of such insurance receivable upon the death of a partner shall not be considered as part of the property of the partnership for purposes of determining the amounts in the capital accounts, and all of such proceeds shall forthwith be paid to the widow or estate of such deceased partner and credited against the obligations of the partnership to the estate of such deceased partner hereunder.

Clause Protecting Senior Partner

Until such time as A's capital account shall equal or exceed the sum of $25,000.00 (or at any time prior to December 31, 196...), B shall have the right to terminate this agreement and to acquire full control of the partnership property and business by paying to A the then balance in A's capital account, plus any salary, commissions or profits then due A. Upon making such payment the partnership created herein and all rights, duties and liabilities thereunder shall forthwith cease.

Equalizing Capital Account

All of a partner's distributive share in excess of Ten Thousand Four Hundred Dollars ($10,400.00), less the effective income tax on such excess, shall be withheld from all partners other than the partner having the largest capital account (or other than the partners having the largest capital accounts if one or more partners have capital accounts in amounts equal to the largest such account). The amounts so withheld shall be credited pro rata to the smaller capital accounts.

Reduction of Capital Account, Repayment for Early Retirement

Until A shall have a capital account equal to or greater than those of the other two partners, he shall, upon voluntary retirement from the partnership, receive no more than ten (10%) percent of his then capital account, multiplied by the number of full years he shall have been a partner, but not to exceed one hundred (100%) percent.

Admission of New Partners

New partners may be admitted by the affirmative vote of three quarters in interest of the partners, but no new partner shall receive more than a five percent interest in the partnership profits without the consent of all of the partners. On admission of a new partner, his percentage interest in the partnership profits shall be taken pro rata from each of the then partners.

Military Leave

A partner who is called into the military service of the United States at any time, or who enters voluntarily in time of war or national emergency, shall retain his status as a partner, but shall receive no salary during his period of service, and in lieu of the partnership interest provided in paragraph 5 hereof, shall receive ....% thereof.

How Commercial Financing Can Be an Economic Tool in the Growth of a Company

Commercial Financing as an Aid to Accountants' Clients

By Francis J. Palamara

Generally speaking, the accounting profession is not fully aware of the value to clients of the commercial finance tool. Because many of the companies in the finance field are factoring companies, there is a tendency on the part of the accountant to confuse commercial financing with factoring. Although the two are quite similar, there is a basic difference between them. Factoring is the service rendered through the acceptance of credit risk on the sales of the factored company and the further service of doing the bookkeeping and collection of the receivables which result from the Factor's having taken the credit risk on the sales purchased by him. Through factoring, a company divests itself of a three-fold responsibility of credit checking, collection, and bookkeeping and guarantees its freedom from loss due to credit failure of his customers. The factored company is able to draw funds when they are required and thereby obtains additional advantage of having a ready borrowing source. For the credit checking service the Factor charges a commission rate applied to sales sold to the Factor, and for the money used by the factored company a charge is made at an interest rate which is usually only slightly in excess of the going bank rates for borrowed money.

The commercial finance tool is quite different in that the financed company does not receive a guarantee of freedom from loss on sales to his customers. The financed company, however, does receive the funds which he requires, the lack of which very often is stifling his growth and, in fact, making day to day operations almost impossible. The need of finance company funds in cases like this is caused by an under-capitalized position.

Finance Companies Provide Capital Funds

Finance Companies do not "lend" money. They provide revolving cap-

ital funds. Perhaps this is a subtle distinction, but realistically, if a company requires borrowed money it should resort to the many commercial banks throughout the country to satisfy that need. The very fact that commercial banks will provide these funds is generally proof of the fact that the capital position of the borrowing company is sufficient to warrant the bank's extension of credit. Banks and commercial finance companies are not in competition with one another for the business they do. The proof of this is that finance companies are among the highest borrowers of money from commercial banks, and commercial banks very frequently refer loans to finance companies when the capital position of the prospective borrower is insufficient for the bank to assume the credit responsibility. This has resulted in many fine pieces of business for the banker, since the financed company which is brought back to economic health through the use of finance company funds usually reverts to the bank which recommended it for its normal borrowed money requirements thereafter.

Through the years the factoring function has been associated with the textile field and in recent years has broadened its scope by entry into the furniture, leather goods, and toy industries. Credit checking requires a specialized knowledge of an industry and, therefore, Factors have concentrated their activities within a few industries. The commercial finance function is not limited in this way since the characteristics of a particular industry do not of themselves have so great a bearing upon the decision to advance the funds required by the borrowing company. This is due to the fact that these funds are secured. Each company in each industry that applies for revolving capital funds stands on its own, and the decision to advance the necessary funds is based upon the ability of the company's management, the diversification of the receivables to be pledged, and the ability of the company to operate at a profit if the funds are made available to it, among other considerations.

Finance Company Interest Rates

Many accountants and much of the public at large who have heard of finance company money have gagged at the rate which is quoted for these funds. This is not a valid reaction if an evaluation of the facts is made. When a company requires capital funds in order to alleviate its money troubles due to its under-capitalized position, it looks first to banks for its answer. When commercial banks cannot extend the credit which is required, the question of equity financing or private borrowing through the issue of capital stock is often considered. A preferred stock issue carrying a fixed dividend rate of 8 per cent, which is not an unreasonable rate to offer for capital funds, would be a satisfactory answer provided that the funds were available in the quantities required. Aside from the cost of fees for obtaining these funds, the company is locked in to a fixed dividend rate applied to a fixed equity capital addition and the dividends are not deductible by the company for tax purposes. The significance of this fact is that should the earnings of the company exceed $25,000 per annum, the effective rate of this capital is 16.6 per cent. If the company earns less than $25,000, the rate is equivalent to 11.4 per cent.

As a rule the accountant who

thinks of this method of curing a company with a poor net worth is the same person who is aghast at the 14 to 15 per cent rate which a commercial finance company offers. As a matter of fact, the finance company dollars are far more valuable to his client because they can be controlled as to quantity, thus cutting to a minimum the dollar cost of these funds. In addition, the management of the under-capitalized client has a highly skilled professionally trained business man in the personage of the account executive who is ready to assist in management counseling which has helped thousands of financed companies with key decisions. This contrasts with the complete lack of such assistance or, in fact, untrained interference from those who provide funds to an under-capitalized company either through a stock issue or a loan.

The accountant is often in a position of having to advise his client as to the means by which financial business hurdles can be negotiated. His clients sometimes have opportunities to buy other companies or to purchase for cash, at a very reasonable amount, the stock or inventory of another company. The working capital position of a client may be low and cash requirements so tight that the trade discounts which are available to the company are very often missed. The financing of an expansion program is often one which raises the question of adding additional capital funds through the issue of capital stock or taking in an additional partner. In weighing the above situations, the accountant must consider the additional tool available to him in the form of commercial financing of accounts receivable which provides a flexible borrowing arrangement whereby his client will receive the funds which are needed, in the amounts which are needed, and at the time they are needed. The loan is self-liquidating through the collections made from the outstanding accounts receivable. In order to keep the interest charges at a minimum, the financed company can borrow only the necessary funds required to meet payables and payrolls. This can be contrasted with the capital loan which carries a fixed interest cost that must be met. Let us avoid confusion at this point by restating that the most desirable method of obtaining business funds is through the means of borrowing from commercial banks at the lowest possible rate and, obviously, companies who are in a position to do this do not require the revolving capital funds which are being offered by commercial finance companies.

The primary consideration in deciding from which source capital funds are to be obtained is not always how much will the money cost, but how can the company afford not to borrow, after full consideration is given to what can be accomplished by use of the borrowed funds. Commercial financing is a tool to be used by companies which are basically prosperous but whose working capital cannot keep pace with its expansion of production and sales. Very often faltering companies will look for accounts receivable financing as a last

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resort, and much to their surprise, find that they are not acceptable borrowers to the commercial finance company that must maintain its integrity by lending only when it believes that its help may revitalize the financial condition of a prospective client.

Illustration

As an illustration of the effect of commercial financing on the balance sheet of a medium sized manufacturer in a typical growth situation, we have presented an illustration showing the balance sheet before and after a commercial finance loan was extended. The illustration fits a manufacturer of a product which sells for one dollar and which costs the company seventy-five cents. Under normal circumstances, a thirty-day supply of the product was maintained in inventory and accounts payable were current. Sales to customers were on thirty days net. This illustration is factual and is based upon a situation which actually occurred.

Sales were good and the management was optimistic. At the end of the first six months the records reflected the following:

January 1

Cash	$100,000
Inventories	75,000
Receivables	100,000

In January 100,000 units were sold, which cost $75,000. The outstanding receivables were collected and with new sales the company showed a $25,000 gross profit.

On February 1 the records reflected the following:

Cash	$125,000
Inventory	75,000
Receivables	100,000

In February sales grew as predicted to 150,000 units. With a corresponding step-up in production to maintain a thirty-day inventory, the company made 200,000 units at a cost of $150,000. All receivables from January sales were collected. Gross profit to date was $62,500.

On March 1 the records reflected the following:

Cash	$ 75,000
Inventory	112,500
Receivables	150,000

As sales increased, so did inventory and receivables.

By May, it was evident that a maximum expansion was well under way. Sales had moved to 300,000 units, while monthly production had reached 350,000 units. It was apparent that the company's greatest need at this point was cash.

On June 1 the position was:

Cash	$ —0—
Inventory	225,000
Receivables	300,000

The economic tool of commercial financing was introduced and a finance company, so often referred to as a Factor, immediately made available $240,000 in accounts receivable financing and $150,000 in a fixed assets loan. The accounts receivable financing served as a revolving fund which flowed to the company as shipments were made and flowed back to the financing institution as receivable collections were made. Funds available increased with the growth in sales.

With ready funds the company made the most of its market opportunities. Within two years sales had grown to about 2,000,000 units per month, while profits and net worth reached gratifying levels. It was at

this point, with the substantial growth in its net worth, that the company returned to the commercial banker for unsecured lines of credit sufficient for its expanded needs.

At the end of this article there appears the balance sheet of this manufacturer at the point at which accounts receivable financing began. This before and after balance sheet is shown in order to answer the typical questions which arise whenever a supplier's credit manager discovers that a customer has turned to a commercial finance company to borrow cash. As a result of commercial financing, the supplier can see that his customer improved his cash position by $50,000; his working capital increased four times, and his current ratio went from 1.04 to 1, to 1.30 to 1. His customer was able to clean up short-term bank indebtedness, liquidate almost half his payables, and take cash discounts on future bills without taking in any partners or tying up the goods which serve as backing for the unsecured credit made available to him by his suppliers.

The entire concept of commercial financing is based upon a relatively short range relationship between the financing institution and the borrower. The thought has been expressed by some accountants that once a company is committed to a commercial finance lending arrangement, he is in the clutches of the lender forever. This is not a fact and can be demonstrated through countless examples of healthy companies who have successfully used the funds they required to revitalize their capital position and restored themselves to financial stability. The confusion between factoring and commercial financing has caused the accountant to assume that the commercial finance relationship is a lengthy one because a Factor and his client have traditionally continued their relationship over many, many years. This stems from the fact that the service performed by the Factor is a continuing one and, as a rule, the money requirements of a factored client are seasonal. The relationship is based upon mutual satisfaction with the service and integrity of the two partners to the contract.

Conclusion

An informed accounting profession is essential to the thousands of companies dependent upon certified public accountants for financial counseling and guidance. With the knowledge that the commercial finance industry is dedicated to integrity and to its obligation to the economy of the country, the accountant can choose the economic tool of commercial financing as a means to strengthening the financial structure of his clients when the circumstances surrounding the immediate situation warrant the use of this facility. The comments made in this article were designed to bring to the attention of the profession the existence of this relatively young industry which has matured to universal acceptance and taken its place in the economic structure of our business world.

"X" Corporation

BALANCE SHEET AS AT JUNE 30, 196...

	Before Financing	After Financing
ASSETS		
Cash	$ — 0 —	$ 50,000
Accounts receivable	300,000	300,000
Inventory	225,000	225,000
Total current assets	525,000	575,000
Fixed assets (net)	280,000	280,000
Other assets	6,000	6,000
Total assets	$811,000	$861,000
LIABILITIES		
Loan payable, secured by accounts receivable	$ — 0 —	$240,000
Bank notes payable	190,000	— 0 —
Accounts payable	260,000	110,000
Accrued taxes	29,000	29,000
Accrued payroll	10,000	10,000
Accrued insurance	3,000	3,000
Current portion of secured long-term debt	— 0 —	50,000
	490,000	442,000
Long-term debt, secured by fixed assets	— 0 —	100,000
Total liabilities	492,000	542,000
CAPITAL	319,000	319,000
Total liabilities and capital	$811,000	$861,000
WORKING CAPITAL		
Current assets	$525,000	$575,000
Current liabilities	492,000	442,000
Working capital	$ 33,000	$133,000
CURRENT RATIO	1.04 to 1	1.30 to 1

A Restaurateur, A Rack of Peanuts, and an Accountant

What Price Progress?

In discussing the costs incident to various types of operations, the analogy was drawn of the Restaurant which adds a rack of peanuts to the counter, intending to pick up a little additional profit in the usual course of business. This analogy was attacked as an oversimplification. However, the accuracy of this analogy is evident when one considers the actual problem faced by the Restaurateur (Joe) as revealed by his Accountant-Efficiency-Expert.

EFF EX: Joe, you said you put in these peanuts because some people ask for them, but do you realize what this rack of peanuts is costing you?

JOE: It ain't gonna cost. 'Sgonna be a profit. Sure, I hadda pay $25 for a fancy rack to holda bags, but the peanuts cost 6¢ a bag and I sell 'em for 10¢. Figger I sell 50 bags a week to start. It'll take 12½ weeks to cover the cost of the rack. After that I gotta clear profit of 4¢ a bag. The more I sell, the more I make.

EFF EX: This is an antiquated and completely unrealistic approach, Joe. Fortunately, modern accounting procedures permit a more accurate picture which reveals the complexities involved.

JOE: Huh?

EFF EX: To be precise, those peanuts must be integrated into your entire operation and be allocated their appropriate share of business overhead. They must share a proportionate part of your expenditures for rent, heat, light, equipment depreciation, decorating, salaries for your waitresses, cook,—

JOE: The cook? What's he gotta do wit'a peanuts? He don' even know I got 'em!

EFF EX: Look, Joe, the cook is in the kitchen, the kitchen prepares the food, the food is what brings people in here, and the people ask to buy peanuts. That's why you must charge a portion of the cook's wages, as well as a part of your own salary to peanut sales. This sheet contains a carefully calculated costs analysis which indicates the peanut operation should pay exactly $1,278 per year toward these general overhead costs.

JOE: The peanuts? $1,278 a year for overhead? The nuts?

EFF EX: It's really a little more than that. You also spend money each week to have the windows washed, to have the place swept out in the mornings. Keep soap in the washroom and provide free cokes to the police. That raises the total to $1,313 per year.

This incident is reproduced from the *Lybrand Journal*, No. 1, 1960. As indicated therein, no source of the paper is known. If any readers can provide us with this information, we shall be delighted to acknowledge our indebtedness and will so inform the editors of the *Lybrand Journal*.

JOE: (Thoughtfully) But the peanut salesman said I'd make money—put 'em on the end of the counter, he said—and get 4¢ a bag profit.

EFF EX: (With a sniff) He's not an accountant. Do you actually know what the portion of the counter occupied by the peanut rack is worth to you?

JOE: Ain't worth nothing—no stool there—just a dead spot at the end.

EFF EX: The modern cost picture permits no dead spots. Your counter contains 60 square feet and your counter business grosses $15,000 a year. Consequently, the square foot of space occupied by the peanut rack is worth $250 per year. Since you have taken area away from general counter use, you must charge the value of the space of the occupant.

JOE: You mean I gotta pay $250 a year more to the peanuts?

EFF EX: Right. That raises their share of the general operating costs to a grant total of $1,563 per year. Now then, if you sell 50 bags of peanuts per week, these allocated costs will amount to 60¢ per bag.

JOE: WHAT?

EFF EX: Obviously, to that must be added your purchase price of 6¢ per bag, which brings the total to 66¢. So you see, by selling peanuts at 10¢ per bag you are losing 56¢ on every sale.

JOE: Somethin's crazy!

EFF EX: Not at all! Here are the figures. They prove your peanut operation cannot stand on its own feet.

JOE: (Brightening) Suppose I sell lotsa peanuts—thousand bags a week 'stead of fifty?

EFF EX: (Tolerantly) Joe, you don't understand the problem. If the volume of peanut sales increases, your operating costs will go up—you'll have to handle more bags, with more time, more depreciation, more everything. The basic principle of accounting is firm on that subject: "The Bigger the Operation the More General Overhead Costs that Must Be Allocated." No, increasing the volume of sales won't help.

JOE: Okay. You so smart, you tell me what I gotta do.

EFF EX: (Condescendingly) Well—you could first reduce operating expenses.

JOE: How?

EFF EX: Move to a building with cheaper rent. Cut salaries. Wash the windows bi-weekly. Have the floor swept only on Thursday. Remove the soap from the washrooms. Decrease the square foot value of your counter. For example, if you can cut your expenses 50% you will reduce the amount allocated to peanuts from $1,563 down to $781.50 per year, reducing the cost to 36¢ per bag.

JOE: (Slowly) That's better?

EFF EX: Much, much better. However, even then you would lose 26¢ per bag if you charge only 10¢. Therefore, you must also raise your selling price. If you want a net profit of 4¢ per bag you would have to charge 40¢.

JOE: (Flabbergasted) You mean even after I cut operating costs 50% I still gotta charge 40¢ for a 10¢ bag of peanuts? Nobody's that nuts about nuts! Who'd buy 'em?

EFF EX: That's a secondary consideration. The point is, at 40¢ you'd be selling at a price based upon a true and proper evaluation of your then reduced costs.

JOE: (Eagerly) Look! I gotta better idea. Why don't I just throw the nuts out—put em in a ash can?

EFF EX: Can you afford it?

JOE: Sure. All I got is about 50 bags of peanuts—cost about three bucks— so I lose $25 on the rack, but I'm outa this nutsy business and no more grief.

EFF EX: (Shaking head) Joe it isn't quite that simple. You are in the peanut business! The minute you throw those peanuts out you are adding $1,563 of annual overhead to the rest of your operation. Joe—be realistic—can you afford to do that?

JOE (Completely crushed) It'sa unbelievable! Last week I was a make money. Now I'm in a trouble—just because I think peanuts on a counter is a gonna bring me some extra profit —justa because I believe 50 bags of peanuts a week is a easy.

EFF EX: (With raised eyebrow) That is the object of modern cost studies, Joe—to dispel those false illusions.

What's Your Time Worth?

All professional men have many demands competing for their time including that all important one of earning a livelihood. Accountants who are earning a salary and those in private practice who have set a goal of earning a specific net income in excess of office overhead may gain a little insight to their problem by reviewing a reprint of a schedule found in our musty, old files.

If You Earn	Every Hour Is Worth	Every Minute Is Worth	In a Year One Hour a Day Is Worth
$ 2,000	$ 1.02	$.0170	$ 250
2,500	1.28	.0213	312
3,000	1.54	.0265	375
3,500	1.79	.0300	437
4,000	2.05	.0341	500
5,000	2.56	.0426	625
6,000	3.07	.0513	760
7,000	3.59	.0598	875
7,500	3.84	.0640	937
8,000	4.10	.0683	1,000
8,500	4.35	.0726	1,063
10,000	5.12	.0852	1,250
12,000	6.15	.1025	1,500
14,000	7.17	.1195	1,750
16,000	8.20	.1366	2,000
20,000	10.25	.1708	2,500
25,000	12.82	.2135	3,125
30,000	15.37	.2561	3,750
35,000	17.93	.2988	4,375
40,000	20.49	.3415	5,000
50,000	25.61	.4269	6,250
75,000	38.42	.6403	9,375
100,000	51.23	.8523	12,500

(Based on 244, eight-hour working days)

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TAX COMMENTS: Prepared by the Committee on Taxation of the Illinois Society of Certified Public Accountants

Deferred Payment Sales

Installment sales and, to a lesser extent, contract sales are such commonplace occurrences in the commercial world that uncertainties containing the tax consequences of these transactions should be expected to arise only rarely. In particular, the tax attributes of the installment method of reporting are thoroughly detailed in the regulations under Section 453 of the Code. Yet these transactions do result in tax litigation, often with rather surprising results.

Qualifying for the Installment Methods

Section 453 of the 1954 Code permits qualifying casual sales of personal property and sales of real property to be reported on the installment method. The well-known advantage of so reporting is the correlation of the seller's tax liability with his receipt of payments from the buyer. The seller does not, as he might have to under other methods of reporting the gain, use capital funds to pay his tax liability on the full amount of the gain in the year of sale. The requirements for qualifying a sale under the installment method are at first glance simple—payments to the seller in the taxable year of the sale must not exceed 30 per cent of the "selling price" and, in the case of a casual sale of personalty, the price must exceed $1,000. These requirements do not apply to dealers, as they usually may elect the installment method as a matter of course.

"Payments" do not include evidences of indebtedness of the purchaser for the purpose of determining compliance with the 30 per cent rule, but do include obligations of third parties which are assigned to the seller as partial payment of the purchase price. Continuing mortgage liens on the property sold are not counted as payments, even though assumed by the buyer, except to the extent that they exceed the seller's basis for the property. Other liens and expenses of the seller assumed by the buyer constitute payments only to the extent that they are discharged by the buyer in the year of sale. Revenue Ruling 60-52, 1960-1 CB 186.

"Selling price" includes all elements of consideration received by the seller such as cash, notes, accrued taxes and interest assumed by the buyer and any lien to which the property sold is subject. Expenses of sale are added to the seller's basis, and thus reduce the gain, but do not reduce the "selling price" or "payments".

The basic rules to be observed by

hopeful installment sellers, as set out in capsule form above, should serve to impress the tax advisor of the need for extreme care in reviewing these transactions. Meticulous compliance with these requirements is a "must". An obvious source of concern and a potential trap in a close-to-30 per cent situation would be the payment by the buyer of accrued taxes and interest assumed by him in the closing. These amounts, when added to the initial payments received by the seller, might total more than 30 per cent of the selling price. Recently litigated issues involving taxpayers seeking to qualify as installment-method sellers illustrate the vigilance with which the Internal Revenue Service polices this area.

The tax advisor should also bear in mind that the tax consequences of failing to qualify for the installment method may go beyond a mere shift between years. In addition to acceleration of payment, the total tax liability can be substantially increased through reporting the entire gain in one year, even with respect to long-term capital gains. Furthermore, the gain reported each year is taxed under the law and at the rates applicable to that year (not the year of sale), although this can lead to favorable as well as unfavorable results. Failure to qualify can not be remedied, while a taxpayer who has qualified can often accelerate the reporting of gain if otherwise desirable.

Mr. Ludlow and Mr. Tombari, two recent petitioners before the Tax Court, were given first hand evidence of that body's willingness to look behind the carefully thought-out language of an installment sale agreement in order to do justice to the realities of the situation. Whether the decision reached by the majority of the court in the *Ludlow* case did equal justice to the Internal Revenue Code was questioned by 3 dissenting judges. *Lewis M. Ludlow,* 36 TC No. 6.

Mr. Ludlow and the 6 other shareholders of Pattin Manufacturing Company accepted an offer to purchase all of Pattin's shares for $1,260,000, $600,000 to be paid in cash and $660,000 over a 10-year period. In order to consummate the sale, however, it was necessary to allocate as much of the purchase price to 3 smaller shareholders as would permit them to receive over $8,000 a share while the 3 larger shareholders were content with $5,400 a share. Furthermore, the 3 larger shareholders informed the buyer that the $600,000 cash payment must be divided between December of 1955 and January of 1956 so that not over 30 per cent of the selling price would be received in 1955. The buyer, who could not care less, accepted these terms.

One of the smaller shareholders, Elliott, was given the task of computing the December payments to be received by each selling shareholder. Overlooking the fact that the per-share price differed between shareholders, Elliott allocated $365,000 (29% of $1,260,000) between the shareholders on the basis of their stock ownership percentages, which payment schedule was inserted in the sales agreement executed on December 29. The buyer delivered checks according to Elliott's schedule the same day. Ludlow and the 2 other larger shareholders received an amount representing 32.2 per cent of the selling price of their shares. Discovering the error on December 30, two of the shareholders managed to wire funds representing the excess

over 30 per cent back to the buyer, but Ludlow's attorney, who was located at a late hour, did not wire the money until December 31 and it did not reach the buyer until January 1.

The Tax Court found as follows:

1. It was Ludlow's intention to receive less than 30 per cent of the selling price in 1955.
2. The insertion of Elliott's schedule as computed by him involved a mistake mutually recognized by the buyer and seller.
3. The word ''payments'' means the ''performance of the consideration provisions in accordance with the parties' true agreement'' and not necessarily the payments called for in the sales agreement and/or actually paid.
4. There was no tax avoidance taint here involved merely because the buyer was willing to pay more than 30 per cent in the year of sale.
5. Accordingly, the payment received by Ludlow in 1955 did not exceed 30 per cent of his selling price.

Three judges dissented, observing that, in accordance with the terms of the contract, Ludlow received in excess of 30 per cent of his selling price, that nobody disputed this receipt and Ludlow could have kept all of it had he desired, and that Section 453 sets out precise requirements which contain no reference to intention but hinge solely on the payments actually made. The efforts of Ludlow's attorney to return part of the payment would make no difference even if they were successful and had been ordered by Ludlow.

Ludlow admittedly presents a strong factual situation which would stir feelings of equity in most critics of the decision. However, it is somewhat unusual to find a decision where a failure to comply with the technical requirements of a tax saving or tax deferring Code provision is excused on the grounds of the existence of an intent to comply coupled with the failure to act, or the erroneous actions, of an agent or attorney. The lesson to be learned from *Ludlow* is perhaps to check and then recheck compliance with the requirements of Section 453, avoid flirting with the 30 per cent limit if possible and sprinkle the factual record with references to the intent of all parties to comply with those requirements.

Mr. Tombari was undoubtedly a taxpayer who also proceeded with firm resolve and intent to meet the 30 per cent test and qualify for the installment method. He sold his pharmacy and the attendant real estate for a purchase price attested by the sales agreement in both capital letters and numerals to be $300,000. In accordance with the agreement, the seller received in 1951, the year of sale, $24,012.36 in cash and a hotel contract on which the obligor owed $75,987.64. In addition, monthly cash payments on the balance totalling $12,770.77 were received by the seller in 1951. The fair market value of the hotel contract was stipulated to be $50,000. The total received in 1951, valuing the hotel contract at $50,000 was $86,783.13, this being less than 30 per cent of $300,000 but in excess of 30 per cent of $274,012.36, the selling price determined by including the hotel contract at its fair market value of $50,000 rather than its face value. It may also be seen that the 30 per cent limit would be exceeded if the contract were included in the amount received at its face value of $75,987.64.

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In order to qualify for the installment method, the taxpayer was forced to maintain that the contract should be included at its fair market value in determining payments received in 1951, but at its face value in computing the selling price. The Tax Court did not see the logic of this position. *William A. Tombari,* 35 TC No. 32. Furthermore, apparently the taxpayer was not astute enough to point out to the Court that he had specifically intended to meet the 30 per cent limit on initial payments, as was obvious from the fact that he almost met it and had intended to avail himself of the installment method.

It is interesting, but not particularly rewarding, to speculate on the process by which Mr. Tombari so neatly entrapped himself. A modest amount of pencil pushing, combined with a knowledge of the basics of the installment method, would have avoided the unfortunate result reached. The certified public accountant should be particularly well qualified to review and pass on the tax consequences of this type of transaction.

Mr. Tombari might have prevailed if he had sold the pharmacy and the realty in two separate transactions, perhaps a cash sale of the real estate (which was subject to a $67,157 mortgage) and a low down payment sale of the pharmacy. This procedure appealed to another druggist who attempted to divide the sale of his pharmacy for $25,000 into a cash sale of the inventories for $10,000 and an installment sale of the equipment, leasehold and goodwill for $15,000. The Tax Court, however, found that a single sale of a going business had taken place and that the 30 per cent limit was not met. *Arkay Drug Co.,* T. C. Memo. Op., Nov. 7, 1944. Whether this result would be extended to embrace the separate sale of a pharmacy and related real estate is conjectural.

Along this latter vein, an interesting situation is explored in a recent decision of the U. S. District Court for the Western District of Kentucky, titled *Erhart et al. v. Gray,* decided February 8, 1961. The owner of half of the outstanding stock in each of two real estate corporations desired to retire and arranged to have his stock retired by the respective corporations. The payments received in the year of sale directly from both corporations totalled less than 30 per cent of the combined selling prices as stated by the parties to the sales, and were also less than 30 per cent on an individual corporation basis, although barely under that limit. However, the stated selling price for one corporation's stock was reduced by the parties from book value so as to reflect an overdraft by the selling stockholder from a partnership which owed a comparable sum to that corporation.

The Commissioner attempted to combine the sale of stock of the two corporations, add the overdraft to the selling price and payments in the year of sale and thereby exceed the 30 per cent limit, and thus deny the use of the installment method for both transactions. The Court agreed that the overdraft barred the application of the method to the one corporation, but refused to disregard the separate corporate entities. It permitted the use of the installment method for the sale to the other corporation. The decision would not only appear to be correct, but dis-

plays a rough justice in its result which is truly in the tradition of King Solomon.

Value—Fair Market and Other

Various types of situations often present themselves where the taxpayer is unable or unwilling to elect the installment method. Some of these are:

1. Contract sales. The seller receives no negotiable notes, mortgage, or other evidence of indebtedness from the buyer, other than the right to receive payments evidenced by a contract.

2. Liquidations. A corporation is liquidated and distributes to its shareholders contractual rights to receive payments from third parties which are indefinite in amount.

3. Deferred payment sales. Property is sold for a fixed price but the time of payment or the fact of payment, or both, are made contingent upon events which are, at least in part, beyond the control of the parties.

4. Indefinite sales price. Property is sold for a price which is contingent upon earnings or some other yardstick. A minimum fixed price may or may not be provided.

It generally is the seller's objective to avoid reporting gain on these transactions until he has recovered his basis in the property sold, and then only as payments are actually received.

The tax consequences of these transactions are often far from clear. The Regulations provide for the recovery of basis prior to reporting gain in the case of deferred payment sales of real estate that do not qualify for the installment method. This method is limited to situations in which the "obligations received by the vendor have no fair market value. . . . Only in rare and extraordinary cases does property have no fair market value." Section 1.453-6(a)-(2). The Service has proven hard to convince in the matter of lack of fair market value, and has indicated that it will continue to require valuation of contractual rights and claims to receive indefinite amounts of income. Revenue Ruling 58-402, 1958-2 CB 15.

There would appear to be two basic principles against which these transactions are tested. The first applies in the case of a cash-basis taxpayer who receives, in addition to a down payment, only a contractual right to receive future payments from the seller. Even though these rights may pertain to a fixed amount payable at fixed times, the Tax Court has refused to require gain to be reported until such time as basis is recovered. *Nina J. Ennis*, 17 TC 465; *C. W. Ennis Estate*, 23 TC 799 (Nonacq.); *C. Hurlburt*, 25 TC 1286 (Nonacq.). The theory supporting this treatment is that, although the contracts may have a value for other purposes such as estate taxation, they can not be considered an "amount realized" (within the meaning of Section 1001) by a cash basis taxpayer, as they are not cash or the equivalent of cash. Obviously, the Commissioner disagrees and has nonacquiesced. In his regulations under Section 1001, the phrase "only in rare and extraordinary cases" again appears with reference to the lack of fair market value of other property received by the seller.

If contractual rights are never the equivalent of cash, and are not to be reported as income by a cash basis taxpayer until payment is received, their value, or lack thereof, should be of no concern. The *C. W. Ennis Estate* decision, however, may indicate otherwise in that contracts which are assignable and commonly as-

signed are intimated to be the equivalent of cash—the Court finding, however, that the particular contracts before it could not be valued. A recent decision of the Court of Appeals for the 5th Circuit rules that a contractual promise to pay that is unconditional and assignable is the equivalent of cash if it is of a type that is regularly transferred to lenders at a discount, and the discount is not substantially greater than that applicable to loans in general. *Frank Cowden, Sr., et al. v. Commissioner,* April 12, 1961.

So it appears that in the contractual area, as well as in the other situations previously described, a determination of the fair market value aspects of the transactions will be necessary. The subject is further confused, more over, by the introduction of the concept of "ascertainable fair market value," which may or may not be equivalent to actual fair market value. This is particularly true where a taxpayer receives contractual rights to an indefinite amount on the liquidation of a corporation or from the sale of assets. In these situations, as well as where the seller is to receive a definite amount under a contract with other than a corporate obligor, ordinary income will result from payments received in excess of the valuation ascribed to the obligations in the year of the sale or liquidation. *Osenbach v. Commissioner,* 198 F.2d 235. This same result may apply with respect to the contractual obligations of a corporate obligor if the obligations do not constitute an "evidence of indebtedness" within the meaning of Section 1232.

However, if the right to payments, however evidenced, has no "ascertainable fair market value," the transaction remains "open" for Federal income tax purposes and the cost recovery method of accounting for the proceeds applies. Moreover, the gain as reported takes the same character as it originally would have —that is, a capital gain remains a capital gain. *Commissioner v. Carter,* 170 F. 2d 911.

Recent decisions have evidenced a reluctance on the part of the courts to determine the existence of ascertainable fair market value where the payments to be received are contingent upon problematical events, such as future earnings. In *John H. Altorfer,* T. C. Memo Op., February 24, 1961, the Court considered the valuation of contractual rights received by the shareholders of a corporation which had sold its assets and had been liquidated. Payments totalling a maximum of $1,200,000 were to be received from the purchaser of the assets, and the seller was given an option to re-acquire the operating assets and intangibles without payment, except for inventories, in the event minimum annual sales were not achieved and minimum annual payments not made. An escrow agreement was set up to permit automatic enforcement of the agreement. The purchaser was not strong financially in relation to the purchase price involved. The Court found that the contractual rights distributed in liquidation had no ascertainable fair market value.

An interesting aspect of the *Altorfer* case is that the taxpayer and Commissioner stipulated that the fair market value of the purchaser's obligations was their maximum value, discounted at 4½ per cent, "if that figure is ascertainable". The Court, through a subtle reasoning process,

used this fact to reinforce its holding, stating that a willing buyer could not be found who would pay any such amount due to the uncertainties involved. Yet, the Court noted, a willing seller, not forced to sell, "could reasonably want a price based on the maximum receivable under the contract."

Thus, it would appear that the term "ascertainable" refers to the existence of a value which is not markedly affected by contingencies and which does not require more estimates and speculation in its determination. The fact that a minimum value can be agreed upon (such as the value of the equipment and real estate held in escrow) does not require a finding that the fair market value of the obligations is ascertainable.

In *Curry v. U. S.*, decided December 14, 1960, the U. S. District Court for the Eastern District of South Carolina determined that the value of a contract which provided for the owner thereof to receive free each year, in perpetuity, a certain amount of electrical power was not ascertainable. The Court pointed to the contingencies involved, such as the possibility that the power company would cease operations, repudiate the contract, or be regulated out of existence or out of its liability under the contract by the State Public Service Commission.

However, in *Chamberlain et al. v. Commissioner,* decided November 30, 1960, the Court of Appeals for the 7th Circuit refused to upset a Tax Court finding that the taxpayer had failed to establish that a contractual right to receive royalties received in exchange for stock had no ascertainable fair market value at the time of the exchange in 1936. Although the amount of royalties which might be received was indefinite, the Court did not consider this a bar to valuation, noting that patents are frequently valued for tax purposes. The Court adopted the view expressed in other recent decisions that the leading case dealing with valuation of rights to indefinite payments, *Burnet v. Logan,* 283 U. S. 404, does not bar valuation as a general rule but merely holds that the facts there presented involved contingencies which might have prevented the return of capital.

On balance, the treatment of situations involving sales on contract or rights to indefinite or contingent payments is still not blessed with that certainty which is so desirable in matters of taxation. Indeed, the taxpayer is faced with a difficult decision. If the contractual rights are not valued but are later determined by a court to have had an ascertainable value, or are valued for a nominal amount, payments received in excess of the valuation chosen will probably be ordinary income. If, on the other hand, a large value is assigned, a capital gains tax may be paid upon amounts which will never be received—and, in any event, paid in advance of the receipt of payments. And, of course, the Service will not rule on the penultimate issue, which is the existence or ascertainability of fair market value.

TAX COMMENTS: Prepared by the Committee on State Taxation of the Illinois Society of Certified Public Accountants

Accounting Problems in Multi-State Taxation

The states of this land of ours levy a bewildering variety of taxes, as we all know—income taxes, franchise-income taxes, pure franchise taxes, sales and use taxes, excise taxes, licenses, fees, property taxes, etc. Some of these are regulatory, but most are levied primarily to produce revenue, a goal which has been in recent years, and in the years to come, will be increasingly sought after by the states.

The costs of big government are not confined solely to Washington. Our states must foot a huge bill for their own ever-increasing services, and new and expanded sources of state revenue are imperative. The states have pursued, with increasing zeal, the interstate or foreign (out of state) corporation as a taxpayer as an alternative to extracting even more tax revenue from local taxpayers—both individual and corporate.

We shall not attempt to review the problems raised by the various property taxes, licenses, etc., but will confine our discussion to questions in respect to net income taxes and franchise taxes based on net income in a multi-state operation.

Jurisdiction to Tax

In the approach to these problems it is well to recognize that over the past two decades there has been a subtle change in the attitude of the courts as to what constitutes a domicile for tax purposes. In the 1940's certain consuming states, as opposed to the manufacturing states, developed a philosophy and test of jurisdiction which we will call the "gainful activity" test. Georgia and California actively pioneered the doctrine that the term "doing business" means any activity or transaction carried on for financial gain.

Such a test of jurisdiction to tax is a far cry from payroll, brick and mortar, goods, order receipt and acceptance, accounting records—all the old trappings of a commercial domicile. We must appreciate that this change in concept of jurisdiction from commercial domicile to gainful activity has taken place, and many corporations, without change in methods of manufacture, selling, and distribution may now be liable for state income taxes. In many instances such liability is retroactive and may

be without the protection of statutes of limitation.

A state's right to tax an out-of-state business always rests on an affirmative answer to the question, does the state have jurisdiction? In turn, this depends on tests of legal domicile (for a domestic corporation), commercial domicile, or gainful activity. All of these are means of establishing a nexus or connection between the taxpayer and the state's market places. With jurisdiction we have tax liability. It is pertinent to mention here that the larger corporations, for the most part, operate in almost all states in such a way as to have a commercial domicile in many states under the older case rules, and the new conception of jurisdiction may have little effect. But even their state income tax load may be heavier as the states tighten up administration. The small and medium sized corporations, doing business across state lines, are most affected by the new jurisdictional concepts.

Once jurisdiction is attained, the apportionment formula takes over. Such formulae vary, but they mainly depend upon an allocation of unitary business income on the basis of the factors of property, payroll, and sales. The property and payroll factors present some problems, but the sales factor appears to present many more. Here again the variations in the states' tax laws operate against the multi-state corporation. It is possible, Public Law 86-272 notwithstanding, to have the same sale included in three different states' numerators: (1) in the state of inventory, (2) in the state of solicitation, and (3) in the state of destination. The consumer states are engaged in a tug of war with the manufacturing states, and the taxpayer is in the middle.

Significance of State Income Tax Issues

What is the significance of these state income tax issues to the independent CPA conducting an audit of a multi-state corporation? There is the problem of recognition of balance sheet liability, first its existence and then its materiality. As we have said earlier, the problem may be less acute in the case of the large corporation. The company's well established commercial domicile in most states has already subjected it to the tax jurisdiction of the states in which it operates, and its tax department normally may be relied upon by the independent CPA as a source of confirmation of state income tax liability, actual or potential.

However, for the small or medium sized corporation the independent CPA must be the tax man. Its problems are likely to be all out of proportion to its size, but the question of materiality of its potential state income tax liability is probably more acute. Physical assets and payroll may be located in relatively few states even though sales effort results in national distribution.

In our opinion, it is necessary to add an expanded tax audit in the state income tax area to the regular audit program. Logically the first step is to get the facts concerning the corporation's business activities. Most of such fact gathering will have to be done by the corporation's personnel under the supervision of the independent CPA.

In order to establish jurisdiction we will need (1) an analysis showing the location by states of all

physical properties, including inventories, with costs and depreciation reserves at both the beginning and end of the accounting period, (2) the location by states of all personnel with dollar payrolls for the accounting period, and (3) the location by states of sales effort. The location of tangible property is usually obvious. However, this factor may involve accounting for goods on consignment at various dates throughout the year. It is also to be noted that some states require capitalization of annual rent as an addition to the property factor. Payrolls must be analyzed to determine the time, mileage, business generated, and earnings of salesmen and other personnel who are employed in more than one state. The greatest controversy will probably arise over the question of what constitutes sufficient sales effort within a particular state to give it jurisdiction. It will be necessary to break down net sales by states as to location of inventory from which shipped and as to destination. We must have an analysis of sales by state of solicitation, by acceptance or approval of orders, and by location of sales offices.

In addition to such analyses of the dollar net sales, we will need information as to the salesmen's activities. In which states do they solicit orders, distribute samples and advertising material, accept payments, maintain an office in their homes, pass on credit, approve orders, show home address on business cards, give technical advice to customers, assist in installation, do customer surveys or market research, etc.? As to the sales orders, we must know where, by state, they are solicited, negotiated, approved, filled by physical appropriation of goods to order, and billed.

The task of assembling such information in regard to sales and selling activities will be colossal unless the accounting records can be set up in advance to yield such analyses. Of course, in a case where accounting is highly mechanized, the task will be comparatively light.

When all of the foregoing information has been assembled, we are in a position to determine in what income-taxing states the corporation has a commercial domicile or sufficient gainful activities to give a state jurisdiction. The taxing statutes of the states vary considerably as to what in-state activities are sufficient to create jurisdiction. There may be a number of states in which our corporation owns property, employs people, or has sales activities which obviously make it liable for income tax. It probably has already recognized the taxing jurisdiction and is filing returns in those states. The extent of the business activities in other states may lead to the tentative conclusion that there is not sufficient nexus under the statute to give the state jurisdiction. The final determination as to whether a particular state has jurisdiction to tax should be made by legal counsel.

After we have determined those states in which our corporation is liable for income tax we turn to the question of how much tax. We have gathered the facts concerning the business activities. We know where the property is located, in what states

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the payroll is paid, and we have the sales analysis. The allocation formulae of the states where income tax returns are being filed should be reviewed for continued validity.

The analysis of business activities may reveal one or more states which apparently have established jurisdiction where tax returns are not being filed. A calculation of the current year's potential tax liability and an estimate of prior years' liability is in order. However, the desirability of filing prior year returns should be considered by legal counsel as there may be some nontax implications.

In connection with the calculation of current or prior year tax liability, it would be well to consider the possibilities of computing the taxable income under separate accounting in lieu of the allocation formula. If a taxpayer can prove that his operation within a state is a business unit in itself, he probably can sustain his position that separate accounting will more properly reflect net income than will the allocation formula. The statutes of most states are drawn so that separate accounting is permissible. However, in some cases separate accounting can be used by state taxing authorities to yield a greater tax than the established allocation formula.

A review of the various state formulae, as applied to the facts of the business activities of a corporation, may reveal a number of situations where a minor change in location of inventory, of sales offices, of method of sales solicitation, or location of sales acceptance or credit approval may save considerable tax. For instance, a warehouse operation could be moved across a state line from a state which uses property as an allocation factor to a state which omits that factor. Or the office where sales are accepted may be changed from a state which bases its sales factor solely on situs of sales approval to an office in a state which does not levy an income tax. If such changes can be made without weakening the sales effort or distribution in any way they may be of considerable advantage tax wise.

Lack of Uniformity in Allocation and Reporting

Taxpayers throughout the land are presently burdened with the heavy costs of accumulating data and of preparing and filing numerous tax returns, no two of which are alike. At the same time the state tax collectors find themselves burdened with disproportionate administrative costs. A great portion of these excessive costs stem from a lack of uniformity in apportionment, in allocation formulae, and in allocation factors. There is also a singular lack of uniformity in methods and forms of reporting. There are inconsistencies in the specific items of corporate incomes and expenses which are required to be allocated. There is no uniformity in the construction of the apportionment formulae being used or in the weighting of the factors employed. There are inconsistencies even in the definitions of such generally understood terms as "sales," "payrolls," and "property." The variations in the definition of the sales factor are what make it possible for three states to claim allocation to each of the same sales dollar. One claims it on the basis of situs of sales office, acceptance, or credit approval, another on the basis of point of shipment of goods, and a third on the destination of goods.

It appears that the great majority of the inequities arising under present taxation methods, based on or measured by net income, would almost be eliminated by the adoption of a uniform method of taxation. The costs of accumulating the necessary facts and the administrative costs of preparing returns would be reduced materially by adoption of uniform allocation formulae and a uniform system and form of reporting.

However, experiences of the past several years have proved that the adoption of such a uniform system of taxation on a wide scale is no simple task. We have the conflict of interest between the taxing authorities of the producing states which tend to favor weighting in favor of the commercial domicile concept, as opposed to the consuming states which desire emphasis on the point of delivery concept.

Uniform Act

In its annual conference meeting in 1957 the National Conference of Commissioners On Uniform State Laws drafted and adopted a Uniform Division of Income for Tax Purposes Act. The proposed act was approved by the American Bar Association in the same year.

The proposed uniform act defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. This is sometimes called the unitary portion of a taxpayer's net income.

For any taxpayer who has taxable income from business activity which is taxable both within and without a state, the act provides for apportionment on the basis of a straight arithmetical average of the percentages produced by three factors, (1) property, (2) payroll, and (3) sales.

The property factor is computed from the average value of the taxpayers real and tangible personal property owned or rented and used during the tax period. Property owned is valued at its original cost rather than its depreciated cost, and rented property is arbitrarily valued at eight times the net annual rental rate.

For the payroll factor, Section 14 of the Uniform Act provides that compensation is considered paid within a state if—

"(a) the individual's service is performed entirely within the state; or

(b) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state."

The foregoing section covering the payroll factor is derived from the Model Unemployment Compensation Act which has been adopted by all the states, and thus the payroll figures are the same as a taxpayer uses for unemployment compensation purposes.

The proposed act handles the controversial sales factor by allocating to a state the sales of, (a) tangible personal property delivered or shipped to a purchaser within the state, regardless of the f. o. b. point or other conditions of sales; and (b) sales of property shipped from an office, store, warehouse, factory, or other place of storage in the state, if the taxpayer is not taxable in the state of the purchaser. All sales to the United States government are allocated to the state within which the factory, warehouse, or other storage place from which the goods are shipped, is located. Separate treatment for sales to the U. S. government is provided because such sales are not necessarily attributable to a market existing in the state to which the goods are originally shipped.

Sales, other than sales of tangible personal property, are allocated to a state if the income producing activity is performed in the state, or, if the income-producing activity is performed both within and without a state, it is allocated to that state where a greater proportion of the income-producing activity is performed, based on costs of performance.

If the allocation provisions of the act do not fairly represent the extent of a taxpayer's business activity in a particular state, the act provides some degree of flexibility in that it provides that the taxpayer may petition or the tax administrator may require, if reasonable:

(a) separate accounting;
(b) the exclusion of one or more of the factors;
(c) the inclusion of one or more additional factors; or
(d) the use of any other method to effectuate an equitable apportionment of a taxpayer's income.

The proposed uniform act also provides for the allocation of such nonunitary sources of income as, (1) rents and royalties, (2) capital gains and losses, (3) interest and dividends, and (4) patent and copyright royalties. Net income from such sources is allocated generally to the state in which the property is located or used or to the state of the taxpayer's commercial domicile.

The term "commercial domicile" is defined as the principal place from which the trade or business of the taxpayer is directed or managed. Such a definition was apparently considered necessary because so many corporations do not carry on any of their principal business activities in the state of incorporation. Another suggested reason for the inclusion of the term is to insure that otherwise untaxed nonbusiness or nonunitary income might be allocated to some state. Section 5 of the proposed act provides that net rents and royalties are allocable to the state in which the property is located or used, but if the taxpayer is not taxable in that state, such rents and royalties are allocable in their entirety to the commercial domicile. This brings into play the arbitrary meaning of the word "taxable" as used in the proposed act. If a taxpayer is conducting business activities in the state in which the property is utilized so that the state could tax if it had an income tax, the income is allocated to that state because it is taxable within the meaning of the act even though it, in fact, is not taxed. Thus, some income would remain untaxed until the state in which the property is located enacts a tax on income.

An acceptable allocation formula must be based upon accounting in-

formation normally computed or capable of computation for business purposes. The three-factor formula which the proposed uniform act provides accomplishes this objective as well as any yet devised.

The property factor, as defined in the Uniform Act, adopts the original cost test and includes the controversial rented property valuation. The original cost concept avoids the variations among taxpayers in depreciation methods, but it may create inequities because of inflation. The payroll factor adopts the tests for determining unemployment tax liability in multi-state situations, and reduces taxpayers' computation burdens. It arouses little or no opposition.

Of course, the sales factor in any allocation formula produces the greatest controversy. The place of destination test adopted in the Uniform Act has the following recommendations:

(a) It affords less opportunity for manipulation of sales operations solely to avoid taxes. Sales offices, salesmen, and warehouses can be moved, but customers cannot.

(b) It recognizes the economic interest of the state providing the market.

(c) It avoids the inequities to purely local but competing businesses which result from other sales tests.

(d) Tests of warehousing and place of credit approval tend to duplicate the property and payroll factors.

The proposed act protects multi-state business by specifying that for purposes of allocation of its income a taxpayer is considered taxable in another state even though it may not be, in fact, subject to an income tax in that state if the state, by constitutional or legislative revision, could levy such a tax. Thus, net income apportioned to Illinois could not be taxed in other jurisdictions.

The Uniform Act does not consider the vexing problem of what constitutes net income. Uniformity in the tax base is an equally important goal in multi-state taxation, as variations in tax base serve to increase the costs of tax accounting, reporting, and administration. Nor does the act attempt a determination of whether a business is subject to the taxing jurisdiction of any state, leaving the solution to the "nexus" problem to others, possibly the Congress.

The proposed Uniform Act does not apply to financial organizations or public utilities, principally because the property, payroll, and receipts formula is not well adapted for apportioning income of such organizations.

The Committee on State and Local Taxation of the Controllers Institute of America prepared and released on February 27, 1959, an alternative proposal for Uniform Division of Income for Tax Purposes Act. The alternative proposal would discard the "commercial domicile" theory as being incompatible with the accepted principle that a state is entitled to use as a measure of its tax only the activities attributable to it and only when the taxpayer is "doing business" in the state. The Committee feels that since the "commercial domicile" theory favors certain states, such as New York and Pennsylvania which enjoy a concentration of commercial domiciles, it would serve to inhibit universal adoption of a uniform act.

The Committee also criticizes the division of income into business and nonbusiness classifications on the grounds that such a division tends to

create administrative problems to both taxpayers and tax administrators. They feel that since financial institutions are not covered by the Act, the distinction between business and nonbusiness sources of income is unnecessary because so-called nonbusiness income constitutes a relatively minor portion of the income of other taxpayers.

The theory that the extent of utilization of tangible personal property or patents in a given state should govern the allocation of income from such property is abandoned in the alternative act as being too costly in record keeping, and in some cases impossible for a licensor to determine.

Conclusion

In the period of almost four years since the proposed Uniform Act was drafted and recommended for enactment by the National Conference of Commissioners On Uniform State Laws, it has generated no great enthusiasm if measured by the number of states which have adopted it. Only two states have enacted the proposed law in its entirety. However, if taxpayers who are subjected to multistate income taxation are ever going to be relieved of their disproportionately heavy costs of record keeping and administration, caused for the most part by the lack of uniformity in allocation and methods of reporting, they must support efforts to bring about uniformity wherever they can.

The recently enacted Public Law 87-17 charges the Judiciary Committee of the House of Representatives and the Senate Finance Committee with the duty to "make full and complete studies of all matters pertaining to the taxation of interstate commerce by the States." Such a study will probably take years to complete, and it will, no doubt, cover the problems of uniformity in allocation and reporting. It seems that the states could relieve taxpayers of the administrative burdens by enacting a uniform law long before such a Federal act may be forced upon them. Taxpayers who are engaged in multi-state operations should urge the enactment of such a law by the states within which they operate.

Quarterly Quip:

Confession of an estate planner who murdered his client:

"He was a good friend of mine and a good client. All of us worked very hard on this thing—the trust officer, the accountant, the insurance man and the lawyers. It was a beautiful set-up. It had trusts with all kinds of remainders; it had reversions and reverters; it had life estates and estates *per autra vie;* it had powers of invasion and powers of appointment; it had all kinds of legacies—general, specific, demonstrative, conditional, limited, residuary, tax-free and tax burdened. There were all of these things and a lot more. It was a beautiful document, and I just couldn't wait long to see whether it would work."

Conducted by the Committee on Local Practitioners of the Illinois Society of Certified Public Accountants

Ideas for Accountants

RETENTION OF PREVIOUS YEARS' TAX SERVICES

The problem of how long to retain past years' Commerce Clearing House or Prentice-Hall tax services is one each accountant faces. It is our opinion that the volume containing the new or current matters be retained indefinitely. This volume generally contains the full account of Revenue Rulings, Technical Releases, Press Releases, etc., for that year. Some of this data is not reprinted or found elsewhere. Further, since these volumes are loose leaf, sheets can be removed and rulings, etc., either photographed for, or mailed to, a client, should the need arise. With regard to retaining the volumes other than the new matters, it is our belief that space availability be the guide for the retention, with six years about the maximum and three years the minimum retention periods. This follows the several statutes of limitations.

COMPARATIVE FIGURES

Keep significant operating figures for your client on a separate schedule in your permanent file working papers. Thus from time to time you can furnish him with long-term comparative figures showing trends either by photographing or typing your working sheets. Your client will be delighted at this additional service, that costs you pennies to provide. Thus, for a retail operation you might keep comparative sales, gross profit, gross profit percentages, rent and salaries in your permanent file and periodically furnish a long-term comparison to your client.

GETTING A RECEIPT FOR INCOME TAX

From Philip Garfinkle comes this idea with respect to getting evidence that an estimate and tax return were filed. If the individual's income tax return for the year shows an overpayment which is applied on the estimate, it may well be that neither the return nor the estimate requires a check. Under such circumstances, we will, wherever possible, bring the first payment on the estimate up to an amount which requires a check if only for a dollar. For example, let's say the client has overpaid his tax by $600.00, which he applies on his estimate. His estimate is $2,000.00, requiring $500.00 as the first installment. The first installment would be shown as $610.00, requiring a $10.00 payment. The client would then have a cancelled check to evidence the fact that an estimate was filed, and also for the income tax return if that return accompanied the estimate when it was filed.

The ideas for this issue were submitted by Robert Heinsimer and Melvin Yudler of Robert Heinsimer & Company, Chicago, and by Philip Garfinkle of Chicago

AS WE GO TO PRESS

ISCPA ANNUAL MEETING

On May 4–6 the Illinois Society held its 58th annual meeting in Springfield. General comments of those in attendance ranged from "very good" to "excellent." Many expressed the thought that the technical sessions were as good as any ever held at a Society annual meeting. While it would be difficult to select a uniformly accepted "high point" in the meetings, certainly Governor Kerner's forceful opening remarks on the real need for revenue reform in the State of Illinois and the session on "The Changing Image of a Profession," featuring Scott Jones, Thomas E. Wise, and John Lawler, would rank at the top. The approximately 300 members in attendance were in accord that President Harry Grossman's successful regime ended on a high note. If you were among the missing in Springfield, plan now to attend the 59th annual meeting next Spring.

CPA EXAMINATION APPRAISAL COMMISSION

The Association of Certified Public Accountant Examiners has recently published the "Report of the CPA Examination Appraisal Commission." This Commission conducted a thorough survey of the Advisory Grading Service offered to the state boards of accountancy by the AICPA and of certain other aspects of the Uniform CPA Examination.

The Report presents the conclusions of the Commission as well as the more detailed findings of the study which support the conclusions drawn. In addition, several exhibits and tables of a statistical nature are presented.

In general the Commission Report concluded that the AICPA examination service and its administration are excellent. "The examinations are well prepared and properly graded, and, in all probability, the grades reflect the competence of the candidates. The uniform examination service safeguards the profession against the induction of more than a nominal number of candidates with comparatively limited qualifications. In this way it protects the public interest while tending to build up in the public mind a highly favorable attitude toward certified public accountants as professionals." Additional conclusions dealt with giving greater publicity to the Advisory Grading Service and its high level of competence, giving greater recognition to the successful performance of earnest candidates, and with a number of technical matters.

The Report is in booklet form (116 pages) and may be obtained from the Association of Certified Public Accountants Examiners, P. O. Box 2988,

Grand Central Station, New York 17, New York; cost $1.00, or $.50 a copy on orders of 10 copies or more.

8th INTERNATIONAL CONGRESS OF ACCOUNTANTS

Plans are well along for the 8th International Congress of Accountants to be held in New York in September 1962. It is presently anticipated that four to five thousand accountants and their families from all over the world will participate. The general theme of the technical sessions will emphasize the relationship to the world economy of the three major areas of an accountants's work—accounting, auditing, and financial reporting. Members of the Society who anticipate participating in the Congress should notify the planning committee of the AICPA at the earliest possible date.

WELCOME TO FLORIDA CERTIFIED PUBLIC ACCOUNTANT

In May a new technical publication, the Florida Certified Public Accountant, joined the ranks of state society professional publications. We welcome its birth and wish it success in the future growth. One interesting feature of the initial issue concerned the policy of the Florida State Board of Accountancy to require applicants for the CPA examination to write an examination covering the rules of ethics promulgated by the Board. Applicants are thereby familiarized with the rules of professional conduct under which they will be expected to live if successful on the CPA examination. Experience with the ethics examination has been so successful that it has been adopted permanently as part of the application procedure for the CPA exam in Florida. This innovation seems to be a reasonable approach to increasing the awareness of candidates to some of their professional responsibilities.

IN THE EDITORIAL MILL

The next several issues of the quarterly are already in the planning stage, and the outlook is particularly interesting. The Autumn issue will feature a series of articles dealing with the general theme "After Fraud Is Discovered." These articles will flow from the Society's successful technical session on this topic held last Fall, and is being coordinated by Mandel Gomberg of Altschuler, Melvoin & Glasser. In the Winter issue the general topic will be "Substandard Reporting." Several papers from the technical session devoted to this topic will be the source of the articles in this issue. In addition, several of the excellent papers presented at the annual meeting in Springfield will be published, as will be the regular features of the quarterly.